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# THE MALAYAN ECONOMIC REVIEW


(*THE JOURNAL OF THE MALAYAN ECONOMIC SOCIETY*)

VOLUME III, No. 2 OCTOBER 1958


## *Contents*





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# MALAYAN ECONOMIC REVIEW

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## *Contents*

# THE CONCEPT OF BALANCED GROWTH IN ECONOMIC DEVELOPMENT — THEORY AND PRACTICE*

By H. W. Singer**

## I. "BALANCED GROWTH"—QUESTIONS OF DEFINITION

It may perhaps help to clear the ground for our discussion to spend a few minutes on terminology. The concept of balanced growth, or of the maintenance of some kind of equilibrium during the process of growth, means different things to different people. Broadly, we may distinguish three classes of usage: (1) a non-technical usage, (2) a general technical usage and (3) a specific technical usage.

1. In the *non-technical* usage, the term is often used to describe such ideas as growth without too much social disruption, broadly-based growth, growth which spreads its benefits widely among different classes, sustained growth, i.e., growth which is neither of such a kind or such a rapidity that it turns out to be a flash in the pan. In its most watered-down versions this non-technical usage comes pretty close to identifying balanced growth with the kind of growth with which the observer agrees; or growth which is considered *ex post* as having turned out to be successful and which is then retrospectively praised with the laudatory epithet of "balanced". For some economists, of course, there can be no higher term of praise than that of balance or equilibrium, and the bestowal of this praise on a certain growth process may then merely amount to a general accolade for a certain country or period. Needless to say, we shall not be concerned with this non-technical usage, even though the problems with which we shall deal will not be found entirely unrelated to these more emotional roots of the concept.

2. In the *general technical sense,* balanced growth may refer to the balance between ambitions and the resources available to satisfy the ambitions, or more narrowly the balance between intended savings and intended investment. Investment is balanced if it fits in with available resources and in this sense can be carried out without inflation, or at least only with that amount of inflation which serves a useful pump-priming function and brings itself to an end. The latter qualification is necessary, although most observers would agree that in under-developed countries he who primes the pump will often find that he has a tiger by the tail instead. Still keeping within the class of general technical usage, the term "balance" may refer not to the equilibrium between aggregate resources and aggregate demands, but to specific resources. It is well understood among the practitioners of economics that the balance of resources and ambitions may be

* This article represents a paper read to the Conference of Economic Development, organized by the Department of Economics of the University of Texas on the occasion of the 75th Anniversary of the Foundation of the University. The paper will also be published in a special supplement to the *Texas Quarterly* for August 1958 and in the *Proceedings* of the Conference. The paper is published here with the kind permission of the Department of Economics of the University of Texas and the Editor of the *Texas Quarterly*. (The somewhat informal conversational style which occurs in parts of the article has been left as it stands, but those references which would be unintelligible to readers outside the context of the Conference have been omitted. Minor omissions have also been made of reference to other papers delivered at the Conference.—Editor).

** The author is a member of the United Nations Secretariat, but the views expressed in this article are his personal views and not necessarily those of the United Nations Organization.

upset not only by excessive demand in the aggregate but also by "bottlenecks" i.e., a failure to match the "mix" of resources with the "mix" of demands or claims upon these resources.

The third "balance" referred to in general technical usage is the external balance, the inter-relationship between the pressure of domestic demand and the need to equalize the incomings and outgoings of foreign exchange, after taking account of intended changes in foreign reserves. It is well understood that developmental investment may be brought up short by the barrier of external balance, even before the barriers of bottlenecks and of the limitation of aggregate resources are reached. Again, under-developed countries may have special reason to worry about the external balance because of their chronically low foreign exchange reserves, their chronically high import demand as a result of demonstration effects and of the facts of technological life, and their chronic difficulties of achieving the desirable degree of export promotion. But although these problems are coming nearer home to our present subject than the ones indicated by non-technical usage, they are not the problems with which I shall be concerned.

3. So now we come to the third, the *specific technical sense* of the concept. In this usage, the term refers to the balance between the size of markets, the volume of supply, and the demand for capital. It is the same balance between the division of labour, the extent of production and the extent of the market which worried Adam Smith. In the more modern literature on under-developed countries, this concern with the balance of markets and supplies often takes the form of a discussion of the balance between different sectors of the economy, e.g., agriculture and industry; or of the need to create the necessary improvements in the efficiency of production which create new markets by a simultaneous expansion of the economic "infrastructure" of health, education, transport, power, housing, etc., together with the more direct expansion of supplies of final goods; or it may take the form of achieving these necessary improvements in the efficiency of production by broadly-based simultaneous investment so that the infrastructure, external economies, economies of large-scale production and the total supply of final goods should go forward together all along the line, and in such a fashion that at each step the increase in real incomes is such that it provides the market for the increased flow of final goods. The "big push," Schumpeter's "waves of investors" and the virtues of the "investment package", are all variations on this theme.

It is with this specific technical use of the term that I am concerned. Essentially, in spite of the rather different form in which this concept expresses itself now, the problem is still Adam Smith's \$64 question — the question of keeping the growth of markets and the growth of supply in balance. As if to emphasize the continuity of the problem from Adam Smith to Nurkse and other more modern writers we have the celebrated article by Allyn Young in the *Economic Journal*, 1928[1] forming such a clear bridge between the two.

## II. STRUCTURAL CHANGE AND THE MARKETING PROBLEM

What then, precisely, is this problem of balanced growth, in its specific technical sense of the problem of "markets"? To help our understanding of the problem, we have to construct some kind of fundamental structural picture — "model" if you like — of an under-developed country. An under-developed country has a clearly defined employment structure: 70 to 90% of the employed population are engaged in agriculture. In a developed country, which has reached the national income levels of North-Western Europe or North America, about 15%

1. "Increasing Returns and Economic Progress".

of the population are engaged in agriculture — more, if the country is a net exporter of agricultural products (or accumulates agricultural surpluses), and less, if the country is an agricultural net importer. However, even those developed countries which are heavy net exporters of agricultural produce — Canada, Australia, New Zealand, Denmark and, yes, even Iowa or Texas[2] — have an employment structure which sets them well apart from the under-developed countries.

An under-developed country then may be defined as a country with 80% of its people in agriculture and a developed country as one with only 15% of its employment in agriculture, in both cases give or take a little according to foreign trade. Arthur Lewis has defined the process of economic growth as the problem of transforming a country from a 5% saver into a 15% saver. We can, with equal justice, define the process as one of transforming a country from an 80% farmer to a 15% farmer. Note that we are speaking here of the employment structure, not of the structure of foreign trade or of the composition of the national income.[3]

The 80% farmer economy, or under-developed economy, has this specific employment structure, because this specific employment structure corresponds exactly to its low level of productivity. The low level of productivity in farming decrees that the bulk of the people must be in farming in order to feed and clothe themselves, and that they have little to spare over and above their own needs. The low level of incomes decrees, by writ of Engel's law, that a very high percentage of the low incomes is spent on food and essential clothing. The demand for other things, particularly manufactured goods and services, is thus limited to a very small percentage of a very small income. This compound effect of low incomes and Engel's law means that the market for non-agricultural goods is exceedingly small. Productivity in agriculture, level of incomes, Engel's law and employment structure form an interdependent equilibrium system. The equilibrium which they determine by their interaction in an under-developed country is a low-level equilibrium.

The above brief description is subject to a significant, but not fundamental, modification arising from the existence of foreign trade: in that case the employment structure is not in direct harmony with the level of incomes and productivity, and the "rest of the world" account must appear as a further determinant. Normally, under-developed countries are net exporters of agricultural products and net importers of other products. Over-populated countries or mining countries can be significant exceptions to this. But the rule remains. As we shall see later, the existence of domestic markets for manufactures presently satisfied by imports from abroad is a significant factor in applying the doctrines of balanced growth. For the moment, however, it is better to stick to fundamentals, and we may think either of the world as a whole, or of a closed economy, or of an under-developed country, the foreign trade of which is balanced in respect of farm and other products.

At this point a second feature should be introduced into our simple model of employment structure. The output: labour ratio in agriculture appears in the statistics almost invariably as lower than the national average ratio. Caution is advisable in connection with this statement. First, there are one or two exceptions to it among the more developed countries — Australia seems to be one of them; yet it remains one of the best-founded generalizations we can make for under-developed countries and developed countries alike. Second, the published figures may understate agricultural output, especialy in connection with subsistence

2. Iowa, 28% and Texas, 16% of total employment in agriculture.

3. I emphasize this because there is frequent confusion on this point.

farming and with agricultural capital formation; hence, my proposition referred to what "appears in the statistics" rather than what *is*. Third, my proposition has doubtful applicability in welfare terms: it is doubtful whether the lower value of output per employed person in agriculture is not largely or wholly offset by lower prices, lower cost, less need for keeping up with the Joneses or other non-pecuniary factors. But when cautiously interpreted I do not think that the evidence for the lower output: labour ratio in agriculture could be contested. In fact for a surprising number of countries the figures come remarkably close to a constant relation of the form:

$$A = \tfrac{2}{3} N$$

where A is output per employed person in agriculture and N is output per employed person in the economy as a whole.[4]

From this differential between agricultural output per person and non-agricultural output per person, there follows with the force of an arithmetical identity a fact of considerable political and emotional significance: if an 80% farmer economy produces only 2/3rds of its national per capita average in the agricultural sector, the differential between the agricultural sector and the non-agricultural sector will be much larger than will be the case in a 15% farmer economy which also produces 2/3rds of its national average in the agricultural sector. In fact, in the under-developed country output per worker outside agriculture compared with agricultural output per worker would be in the ratio of 3½:1. Thus, structural change in the sense of moving from an 80% farmer economy in the direction of a 15% farmer economy begins to look like being more than a *symptom* or *measure* of economic development; it begins to look like a *method* or *instrument* of economic development.

This impression is understandable, but it is doubly fallacious. In the first place, any transfer from agriculture which is not justified by the level of productivity and the state of real demand or markets cannot possibly be maintained or beneficial. In the second place, the higher output per person outside agriculture is not in itself conclusive evidence of a more favourable capital: output ratio outside agriculture than inside, neither in the average sense nor in the marginal sense relevant for allocation of available capital. However, the magic of this differential is understandable. Moreover, in spite of the basic fallacies involved — as has just been pointed out — there is an element at least of truth in the idea that this differential could be utilized in economic development. In so far as the greater output per person outside agriculture does in fact represent greater net productivity of labour, derived from internal and external economies, and not only a greater input of capital, a cumulative or multiplier effect is introduced into the process of structural change. As the levels of productivity and of real demand and markets rise, the structural change from an 80% farmer economy towards a 15% farmer economy made possible by this rise will in its turn generate forces which themselves tend to raise productivity and real incomes. In this fashion the effect may become the cause and we are in the midst of a hen-and-egg riddle. Here, in a nutshell, we have the starting point of the doctrine of balanced growth in the more modern form developed by Rosenstein-Rodan, Nurkse and others: the

4. The form in which the equation is presented fails to bring out clearly the implied compound relationship, i.e., that the ratio of output per person outside agriculture to the one inside agriculture is a diminishing function of the importance of agriculture to the economy, as explained in the next sentence. From $A = \frac{2}{3} N$, it follows that $X = \frac{150 - Y}{100 - Y}$ where X is the ratio of non-agricultural per capita income to agricultural per capita income, and where Y is the percentage of the population in agriculture. I am indebted to my colleague, Mr. Martin Ekker, for pointing this out to me.

self-justifying broadening of real demand and markets, the investment which looks uneconomical *ex ante*, but becomes economical *ex post*, the shipwreck which yet helps to set off the wave which will float it off the rock.

### III. "BALANCED GROWTH"—A *POSSIBLE* SOLUTION, BUT OF DOUBTFUL APPLICABILITY

We have now established that a shift in the employment structure from agriculture towards non-agriculture, especially industry, can be considered as an inevitable accompaniment of economic development. This is certainly true for a closed economy and, with a certain time lag, almost certainly true also for an open economy. We have further seen that in a very limited sense it might even be said that the process of transfer itself can help to promote economic development. At the same time, we have seen that the extent of the market — reflecting the state of real incomes, the institutional framework and the state of foreign trade — sets strict limits to this required, and desired, shift in the employment structure. Industry cannot expand because it needs expanded markets in agriculture, and agricultural marketing, in turn, is limited by the absence of employment opportunities in industry which forces agriculture to feed too many people on the farms. Individual industries cannot expand because they lack markets due to the lack of development of other industries.

The doctrine of balanced economic growth, in its specific technical sense, offers a way of solving this marketing difficulty. Perhaps it would be more correct to say that it offers a way of by-passing the marketing difficulty. What it says, in effect, is this: "Let us leave the present system alone, deadlocked in low-level equilibrium. Let us superimpose upon this deadlocked system a second, self-contained, system which provides additional markets, at the same time as it provides additional supply. Let us create this second self-contained system with emphasis on the sector which would in any case have to be expanded in the process of economic growth, and which is also the sector where simultaneous projects can most readily support each other. The way to do this is by a simultaneous wave of new plants, composed in such a way that full advantage is taken of complementarities and external economies on the supply side, and of the complementarities of markets on the demand side." In this way, it is explained — to use a metaphor coined in a rather different context — 100 flowers may grow where one single flower would wither away for lack of nourishment.

In other words, we are told that the marketing difficulty looks formidable only to our habit of thinking small, in terms of piecemeal projects. "Stop thinking piecemeal, start thinking big", we are told, "and the marketing difficulty which seemed to loom so formidable will turn out to be a paper tiger".

Let it be said at once that this doctrine must command respect and sympathy. Advice to under-developed countries to stop thinking piecemeal and to start thinking big, is sound advice. The programming approach is better than the project approach. In a good development programme, individual projects can and should mutually support each other; if proper advantage is taken of such opportunities, the productivity of investment can be significantly increased. A wide-spread expectation among individual entrepreneurs that the demand for their product is going to increase, can do wonders with the inducement to invest, and it can be self-justifying, as far as the demand side is concerned.

Yet there remain several areas of doubt — indeed of rather obvious doubt — about this approach. In the first place, it seems obvious that a purely non-agricultural system of additional markets can never be entirely self-contained. Engel's Law may say that the demand for food increases less than in proportion to income, but it certainly does *not* say that the demand for food does not increase

at all — and most particularly not at the low income levels of under-developed countries. Moreover, it is fallacious to think of the new system of additional markets and the old deadlocked system as unrelated to each other. Where you have the institution of family subsistence farming, as the employment structure changes and people are drawn off the land, the demand for food per capita of those remaining on the land will increase with their increasing real income. This increase in demand for food will be additional to the increase in the demand for food of those drawn off the land.

All this is well known and much discussed,[5] but the implications for the doctrine of balanced growth have not perhaps been fully realized. The implications are that the big push in industry may have to be supplemented by large-scale investments in agriculture additional to the "balanced diet" element in the package. But once this is admitted, two consequences follow: in the first place, the doctrine begins to look suspiciously like the more orthodox doctrines — with which Adam Smith would not have quarrelled — that structural change must rest on a foundation of raising productivity within the existing structure (and in under-developed countries that means mainly agriculture), until real incomes have risen to a level which justifies structural change. Even more damaging to the doctrine, at least in its practical application, is a second consequence of the admission that the widening of markets must include major additional blocks of investment in agriculture. The total resources required for the big industrial push may already be too large for an under-developed country. But even they are not sufficient: we must further add to the required resources not only the investment needed in agriculture which is needed to make the new system self-contained, and remove the market difficulty, but further blocks of investment to cater for the higher real incomes of those not transferred from agriculture.

The reason why these difficulties are more clearly seen in connection with the problem of sectoral balance between agriculture and industry, rather than in their implications for the specific doctrine of balanced growth, lies probably in a lingering belief that the required changes in agricultural supplies could be brought about by institutional changes rather than by new investment. While it is true that reduction of population pressure may make it easier to introduce institutional reforms, such as consolidation of holdings, introduction of commercial crops, experimentation with better farming methods, etc., yet once the subject is brought out into the open, the need for agricultural investment would be fairly generally admitted. But still at the same time the argument is often conducted along lines which seem to neglect this need.

A second obvious area of doubt about the doctrine is already implied in what has been said just now. We may put it in the words of Marcus Fleming[6]: "The situation might be roughly expressed by saying that, whereas the balanced growth doctrine assumes that the relationship between industries is for the most part complementary, the limitation of factor supply ensures that that relationship is for the most part competitive."

We may say that the resources required for carrying out the policy of balanced growth — particularly when the extension to agriculture just made is borne in mind — are of such an order of magnitude that a country disposing of such resources would in fact not be under-developed. A slightly different way of putting the same point would be to say that the doctrine may be more useful as a recipe for sustained growth in developed countries, than as a recipe for break-

5. Indeed, Nurkse's linking of the "balanced investment" package with the need for a "balanced diet" gives telling recognition to this connection.

6. "External Economies and the Doctrine of Balanced Growth", *Economic Journal* June 1955, page 246.

ing the low-level equilibrium deadlock in under-developed countries. To justify the doctrine, as a recipe for breaking the deadlock, it would really have to be argued that the required resources, even though not initially available, would be forthcoming under the pressure of widened markets and balanced growth of demand. But this also would hardly be compatible with the assumed inelasticities of factor supply in under-developed countries. If pump-priming were the answer, the problems of under-developed countries would not be as tough as they seem to be. This issue has been clearly brought out by Mr. Fleming and his subsequent discussion with Professor Nurkse in the *Economic Journal.*[7]

It may be tempting to try to vindicate the doctrine by some argument along the following lines: "True, the balanced investment package requires large resources, but these can be provided by a pump-priming process. The savings of under-developed countries may not be sufficient to provide the required resources *ex ante*. But if the balanced investment can be physically realized in the first place, the required savings will be provided *ex post*. So there is nothing to worry about, really." But this argument presumably must assume that the marginal rates of savings and taxation are sufficiently high to secure the *ex post* identity of savings and investment without too much inflation; unless indeed it refers to a fleeting identity brought about as part of a continued galloping inflation.

In any case, however, the argument cannot vindicate the doctrine. In so far as the additional incomes are saved or taxed away, it is true that the insufficiency of resources no longer furnishes an argument against the approach. But this is only achieved at the price of removing the initial justification for the whole operation. For it stands to reason that in so far as additional incomes have to be saved or taxed away, these incomes are not available to provide the required markets. Supply can create its own demand, or it can create its own finance — but it cannot conceivably do both. Therefore, to recommend the balanced investment package as a device simultaneously to solve the marketing deadlock and to solve the deadlock of insufficient resources, is to become the victim of a double-counting trick. Where pump-priming *can* be successfully practised — probably not a frequent case in under-developed countries — that is fine but there is no particular point about pump-priming by means of balanced investment packages.

The argument proves the doctrine of balanced growth *premature* rather than *wrong*, in the sense that it is applicable to a subsequent stage of sustained growth rather than the breaking of a deadlock. It may well be better development strategy to concentrate available resources on types of investment which help to make the economic system more elastic, more capable of expansion under the stimulus of expanded markets and expanding demand. This would draw our attention to investments designed to strengthen the economic and social foundation or "infrastructure": health and education, transport and communications, energy and power, skills and knowledge of resources. Added to this general strengthening of the foundations, there would have to be investment designed to remove specific bottlenecks as they have arisen as a result of previous growth and recent economic history. As before, if we assume that such a system of investment could be simultaneously undertaken with the wave of directly productive projects described by the doctrine of balanced growth, all would be well. There is certainly nothing inherently contradictory about the two areas of investment. But by thus increasing even further the required size of the investment "package" so as to include the public foundation services required for expansion, we remove the whole idea even further from the realm of practical dvelopment policy in under-developed countries. And if a choice has to be made, it is difficut to avoid a sequence in which, during the early stages, "foundation" investment is bound

7. June 1955 and September 1956.

to predominate. For such investment, which is essentially promotional and does not itself produce goods sold in the final market, the marketing difficulty in the normal sense does not exist. This investment also has the purpose of *creating* markets, but by a different route than "balanced growth", namely by creating conditions where subsequent individual projects become economically feasible as a result of lowering their real cost of production. Where the choice is between the simultaneous creation of complementary high-cost plants — high cost for lack of skills, transport, power, etc. — on the one hand, and the improvement of transport, power, etc., combined with investment in such selected individual projects as have become economical as a result of lower real cost on the other hand, who can doubt what the better resource allocation in an under-developed country is?

To summarize: in spite of its intellectually satisfying features, the doctrine of balanced economic growth has severe limitations in its applicability to under-developed countries. While it rightly insists on marketing difficulties as a cause of low-level equilibrium, and while it rightly shows that the marketing difficulty can be overcome by a broadly-based balanced investment programme, it fails to come to direct grips with an even more fundamental problem of under-developed countries, i.e., the shortage of resources. It may be true that supply of goods — provided it is properly composed and properly balanced — will create its own demand. But supply of goods means demand for factors of production, and specially for capital; and while supply of goods may create its own demand, unfortunately in under-developed countries demand for factors does not create its own supply. Worse, the demand for factors implied in the broadly-based investment programme must be in direct competition with other investment projects and other types of expenditure whose direct objective it is to increase available resources. If both types of investment could be undertaken simultaneously, all would be well and the doctrine would be fully vindicated. But in that case the concept of balanced economic growth would have to be broadened considerably beyond what is normally implied. The doctrine would then come perilously close to saying: "If only the economic problem did not exist (i.e., if resources were not scarce and everything could be done simultaneously) then the problem of development could be solved." This is a somewhat unfair *reductio ad absurdum*, but it does bring out the severe limitations of the doctrine. The more urgent the problem of economic development is, the more the doctrine fails to apply. The more the doctrine applies, the more the problem of development is likely to take care of itself.

If the doctrine has merits in pointing out the marketing difficulty and in describing a way of making investment more productive, it also has dangers in that its inherent limitations may be ignored. The intellectual appeal of the doctrine, together with its direct association with the desired structural change, may lead countries to apply it even in situations of resource shortage and of resource inflexibility. In that case it will lead to policies which reduce rather than increase the productivity of investment. It will either lead to inflation, or to a formulation of balanced investment packages on a very narrow geographical base, or else to costly sacrifices of other types of investment on the altar of balanced growth. To return to our previous paraphrase: it is sound to advise under-developed countries to "think big", i.e., in terms of aggregate national income accounts — but it may not be sound advice to tell them to "act big" or at any rate bigger than their resources permit.

It should be emphasized that the doubts that must attach to the doctrine of balanced growth refer to the applicability and operational value of the "wave of investments" or "balanced investment package" in under-developed countries, rather than to its intellectual validity or even to its operational value in the different circumstances assumed by Schumpeter in his "Theory of Economic Development". Professor Nurkse, for instance, who took a leading part in relating the

Schumpeterian idea to the marketing deadlock in under-developed countries, and thus evolved the idea of expanding markets by balanced investment packages, makes it abundantly clear that he is aware of the limitations here suggested: "There is no suggestion here that, by taking care of the demand side alone, any country could, as it were, lift itself up by its boot-straps. We have been considering one particular facet of our subject. The more fundamental difficulties that lie on the supply side have so far been kept off-stage for the sake of orderly discussion."[8] But our problem here is not "orderly discussion": it is economic development. Our paper is called the "Concept of Balanced Growth in Economic Development — Theory *and Practice*". The trouble with Professor Nurkse's approach is that the remedy for the demand side that he proposes, puts a particularly heavy strain on the supply side which in any case is the "fundamental difficulty", in his own words. It is perhaps a pity that the chapter entitled "The Size of the Market and the Inducement to Invest" should have been the first rather than the last chapter of his great book. This has given rise to some misunderstanding. Nor has this misunderstanding been confined to one side only. When Mr. Fleming raised the supply problem, Professor Nurkse objected that: "The word 'growth' alone hints that something more is involved than, e.g., the rules of allocating a given factor stock (which, in their proper place, are not to be disparaged). This is all the more evident if attention is paid to the context in which the balanced-growth idea has turned up in the literature. My own assumption, in Chapter I of my book was that of a given labour force being equipped with an increased stock of capital."[9]

But Professor Nurkse's assumption, so clearly stated in his last sentence, does not remove the objections. The fact is that even though we may assume that resources are available for net investment, so that "a given labour force is being equipped with an increased stock of capital", the additional capital still has to be carefully allocated and the investment package will have to compete on its own merits together with other possible ways of utilizing "the increased stock of capital". It is by no means certain that the right strategy for an under-developed country is the "frontal attack of this sort — the wave of capital investments in a number of different industries"[10] that Professor Nurkse writes about. Perhaps guerilla tactics are more suitable for the circumstances of under-developed countries than a frontal attack.

## IV. A BALANCED VIEW OF BALANCED GROWTH

In the preceding section, we have described the doctrine of balanced growth as a possible solution and one with some educational merit for under-developed countries, but on the other hand as an incomplete, implausible and even potentially dangerous solution. Perhaps it is well now to amplify this judgement, by standing back and taking a broader view of the problem involved. For this purpose, we may perhaps re-introduce the elementary sketch of an under-developed economy used before. Our little sketch tells us that there are several distinct roads to economic growth.

1. In the first place and most obviously, there is the increase in productivity in agriculture. It is not unnatural that foreign missions to under-developed countries should emphasize this road to economic growth: any visitor to an under-developed country will observe first, that the bulk of the population — about 80% in our sketch — is employed in agriculture; and second, that agriculture is carried on at a particularly low level of productivity, not only in relation to agriculture in more advanced countries, but also in relation to other occupations

8. Ragnar Nurkse. *Problems of Capital Formation in Underdeveloped Countries*, Oxford. 1957, pp. 30-31.

9. "Balanced Growth on Static Assumptions", *Economic Journal*, Vol. LXVI, 1956, p. 366.

10. *Loc. cit.*, page 13.

in the same under-developed country. All this is described in our sketch. High productivity in agriculture must certainly be one of the main roads to economic growth. When it occurs it would normally solve the marketing difficulty; the higher income of farmers will provide expanded markets for industries and, according to Engel's Law, part of the additional demand is likely to be for non-agricultural products. Note, however, that the solution of the marketing difficulty through higher agricultural productivity is by no means automatic: where the high productivity results in a higher level of feeding for the extended family of the subsistence farmer, it is still clearly a good thing — but it does not remove the marketing difficulty from the path of structural change. Where improvements in agricultural productivity occur in relation to commercial crops, and even more so where they occur in relation to export crops, we can be reasonably certain that such improvements will create pre-conditions for growth, and enable us to dispense with the balanced investment package as a specific remedy for marketing troubles. Where agricultural productivity rises within a system of subsistence farming, it should normally be possible for an enlightened government to link this rise in productivity with institutional changes which would utilize it as a foundaton of growth. For example, where the higher agricultural productivity is accompanied by the offer of "incentive goods" to farmers which will induce them to develop a propensity to "truck, barter and exchange" as their output increases, growth becomes possible as a result. Furthermore, an increase in agricultural productivity, in so far as it releases labour from the farm, creates part of that elasticity of factor supply which makes the balanced investment package possible.

2. In the second place, there is improvement of productivity outside agriculture, and specifically in industry. There is plenty of evidence to show enormous scope for such improvement. It would indeed be surprising if it were otherwise, considering the lack of experience in handling capital, the scarcity of managerial skills, the absence of supporting managerial services and of external economies, the absence of maintenance and repair facilities, etc. We may perhaps add to this list the fact that the technology used is an alien growth imported from abroad, and has therefore not developed in line with the requirements and resource endowments of the under-developed countries. The pioneer study by the United Nations Economic Commission for Latin America[11] on cotton textile industries may perhaps be quoted as providing many illustrations of possible improvements in efficiency. Such improvements outside agriculture may be not so obvious, especially to the outside observer, as the need for higher productivity in agriculture. But even though agriculture may employ 70-80% of the total population, it does not normally account for more than half the national income.[12] It follows that a given degree of improvement in the non-agricultural sectors will increase total real incomes by about as much as the same degree of agricutural improvement. Investments designed to raise non-agricultural productivity, by lowering real cost curves, will create "markets" where none existed before, and they do so without the need for a broadly-based investment package.

3. Thirdly, the low-level equilibrium deadlock of real incomes and markets exists only in a closed economy, or for the world as a whole. In any individual under-developed country with significant foreign trade — and that means nearly all under-developed countries — some of the markets lie abroad, and hence are not limited by the low domestic incomes. These markets are, of course, also limited: by real incomes abroad, by competition from possibly lower cost competitors, by

11. "Labour Productivity of the Cotton Textile Industry in Five Latin-American Countries", (Sales No. 1951. II. G.2.)

12. In our structural sketch, agriculture provides 80% of the employment but only 53% ($80 \times \frac{2}{3}$) of the national income.

technological changes, by development of synthetics, etc. Furthermore, the notorious instability of world commodity prices may make markets abroad particularly hazardous for the specialized exporter. All the same, export promotion offers a historically and analytically most important method of by-passing the marketing deadlock, offering opportunities for economic growth without the balanced investment package.

4. Fourthly, by the same token, a country engaged in foreign trade has established domestic markets presently supplied by imports from abroad. Import substitution, like export promotion, thus offers an opportunity of growth in happy disregard of the need for an investment package. The protective tariff has historically been a major alternative to the balanced investment package, in the early stages of development. Arthur Lewis' "Report on the Industrialization of the Gold Coast" provides the *locus classicus* for this unbalanced, yet effective, approach.

5. Fifthly, and related to the improvement of productivity, there is the approach to economic growth *via* the building up of the economic infrastructure. Here, perhaps investment in transport facilities is most obviously an alternative to the balanced investment package as a method of creating new markets. The absence of markets in under-developed countries is not merely a question of low real incomes, it is also a question of the specific economic framework and institutions in which the incomes are earned. If the division of labour depends on the extent of the market, the market in turn depends on the extent in which certain facilities are provided. Transport is the most obvious of these facilities. The doctrine of balanced economic growth is right in emphasizing the creation of markets as a key problem, but one can create markets by methods other than by inducing balanced demand. "Infrastructure" investment in under-developed countries is best considered as mainly of the "autonomous type", and governed by final demand only in some rather vague, technological sense.

6. Sixthly, and quite apart from foreign trade, it would be unrealistic to assume a state of perfect harmony — even the harmony of the deadlock — between markets and supplies. The doctrine of balanced growth seems to assume that in making decisions on the allocation of resources in an under-developed country we start from scratch. That, of course, is not so. Rather, we start with a situation which incorporates the effects of previous investment and previous developments. This means that at any given point of time there are types of investment which are *not* in themselves balanced investment packages, but which are complementary to existing investments, and thus bring the total stock of capital nearer balance. We must thus distinguish between balance as the end result at which to aim, and balance as the method of approach. Where you start with imbalance, you need *further imbalance*[13] in order to come closer to balance.

It may be said that this still leaves the concept of the balanced investment package valid, only stretching it over several investment periods. The trouble is that life does not stand still. While we are aiming at better balance by unbalanced "bottleneck" investment, conditions change again and at the end of our investment period we are left with a new imbalance; with new bottlenecks which we then must try to remedy by a further set of unbalanced bottleneck projects. Thus, while we may be aiming at balance as an investment criterion, we achieve this objective by unbalanced investment. The ideal that we aim at, constantly eludes us and has to be constantly pursued by methods which are not the ones recommended by the doctrine of balanced growth. The metaphor of the man chasing a rabbit from a point sideways to the path of the rabbit has been used in other

13. Professor Lerner suggests to me the terms "re-balance" or "disimbalance"—by analogy with reflation or disinflation.

branches of economics, but it is also apposite here. The hunter is governed by the path of the rabbit, but by directing his own path at each moment directly at the moving objective he will in fact describe an erratic path, quite different from that of the rabbit itself. It is suggested here that the path of economic development is more like that of the hunter than that of the rabbit streaking in a straight line to its refuge. The situations where the balanced investment package is appropriate would be at the two extremes: where investment starts entirely from scratch on the one hand, or where development continues from such a high level that existing bottlenecks are relatively unimportant.

We have now described six alternative approaches, other than those singled out by the doctrine of "balanced growth". Each of these alternative approaches could conceivably, if successfully pursued, resolve the marketing deadlock which gave origin to the doctrine of balanced growth. Thus balanced growth should be judged not as a sole cure for the evil correctly diagnosed but as one of several possible cures. Which of the various cures will be the most appropriate, will then depend on specific situations, and more particularly on the total volume of available resources. In this respect, the specific cure of the balanced investment package does not compare well in the early stages of development, because it requires large resources — in fact larger resources than most expositions of the doctrine seem to realise. The balanced investment package cannot logically be confined to a group of projects which are self-supporting on the demand side; the package must include investment in agriculture and in the infrastructure. The cure is not only far from being the sole cure, it is also an expensive cure and one which is most effective when taken as a mixture with other prescriptions.

But having thus defined the limitations of the doctrine, we are now perhaps in a better position also to appreciate its merits: the combination of self-supporting projects can serve to raise the productivity of investment. In particular, it can prevent the creation of "white elephants" — projects without a market — which dot the landscape in so many under-developed countries as standing monuments to folly and waste. As between alternative appropriations of *given* resources, the balanced investment package has an inherent superiority — wherever the available resources are sufficient for such packages.

There is another lesson which we can learn from the doctrine of balanced growth. The inducement to invest will be greatly increased by anticipation of expanding markets and expanding incomes. Inflationary expectations are one way of raising the inducement to invest; an expectation of real growth would be just as effective — perhaps more effective. It is not sufficient for complementary investment which will provide markets actually to go forward; it is also necessary that it should be seen or known, or at least assumed, to go forward. For this reason, in any development programme of an under-developed country it is crucially important to create a general sense of moving forward. The very formulation of development programmes may be helpful in creating such a sense of moving forward — more specifically, I believe that this is also one of the most important effects of the community development movement in India. Balanced growth can play a part in improving what in trade cycle theory is perhaps rather vaguely called "the state of business confidence". A low-level deadlock of incomes and markets can be due to excessive self-justifying pessimism concerning future markets, particularly where there is a long history of stagnation or economic troubles. It is, however, not so easy for excessive optimism to be self-justifying — the inexorable limitation of resources stands in the way. Where the low-level equilibrium has been determined by excessive pessimism rather than by resource limitation, the doctrine of balanced growth acquires considerable theoretical as well as practical merits.

Finally, let us remember that the objections to the doctrine of balanced growth will be greatly reduced and finally vanish, as the available resources increase in the course of economic growth. Thus interpreted, the doctrine should stimulate under-developed countries to undertake the necessary sacrifices in the early stages of developmnt; it dangles a carrot before them that one day when resources have become big enough, balanced investment packages will become possible. Having laboured to the top, the balanced investment package will help them to "slide down the other side of the roof", into the promised land of cumulative growth and compound interest.

# MORE MONOPOLISTIC COMPETITION THEORY*

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## I

Twenty five years ago Professor Chamberlin gave us one of the outstanding works in economic theory of this century, the *Theory of Monopolistic Competition*.[1] The present volume, giving us the results of further work on the subject and of many years of graduate teaching at Harvard, might have made an equally impressive contribution. In the remarkable chapter on the product as an economic variable (reprinted from the *Quarterly Journal of Economics*, February, 1953) where the quality of the thought on standards suggests the moral insights of Ruskin, and the subtlety of the modern analytical philosophers, while the use of spatial analogies introduces significant new techniques, we are shown how important a contribution would have been made if this great economist had really written a book on the theme proposed in his title.

A very high proportion of the book is devoted to controversy, some of it merely reproducing, without change, journal articles where the articles criticised cannot appear. This makes for very arid reading. Most of the points made by Professor Chamberlin would have been impressed on the public more adequately by developing his own theory into new fields, instead of re-emphasizing so polemically its undoubted great qualities.

Yet, even though it is unfortunate that the creator of this theory should incur widespread criticisms by spending so much effort in controversy, it is impossible for any honest reviewer to avoid the conviction that his theory has been a victim of misfortune and misrepresentation.

Mr. Kaldor's gibe[2] that Professor Chamberlin was exemplifying his own theory by differentiating his own product from Mrs. Robinson's *Imperfect Competition*[3] has provided hundreds of economists with a classroom joke and an excuse to avoid further thought. Yet the differences between the two theories are significant, and in trying to disentangle them Professor Chamberlin is performing a real service.

His manner will no doubt deter many from grasping his points. For he seems to recognise none of the present generation of economists as worthy of serious consideration. Mrs. Robinson is not the only one attacked, an economist whose work in other fields (even if one greatly prefers *The Theory of Monopolistic Competition* to *The Economics of Imperfect Competition*) is hardly inferior to his own. The same contempt is poured on Hicks and Harrod, Knight, Stigler and Friedman, and even Keynes. He is so anxious to claim complete generality for his theory that he claims it as macroeconomic as well as microeconomic, though

* Being a review article on: E. H. Chamberlin, *Towards a More General Theory of Value*, New York: Oxford University Press, 1957.

1. E. H. Chamberlin, *The Theory of Monopolistic Competition*, Cambridge: Harvard University Press, 1933.

2. N. Kaldor, "Professor Chamberlin on Monopolistic and Imperfect Competition," *Quarterly Journal of Economics*, Vol. 52, 1938, p. 525.

3. Joan Robinson, *The Economics of Imperfect Competition*, London: Macmillan, 1933.

the footnote illustrating his reasoning is very obscure,[4] and appears to imply that it is a form of macroeconomic theory because monopolistic competition could in principle be assumed in some of the functions in a macroeconomic model.

These weaknesses, irritating though they are, should not be overemphasized. Professor Chamberlin produced a set of concepts that could have revolutionised the whole of value theory and extended their influence widely through the different fields of economics. Within a year of their publication these concepts were hopelessly entangled with superficially similar ones, simultaneously developed in a work on a much lower level of generality, which was original mainly in its techniques, and oriented to a political objective. If, oppressed with the rapidly spreading forest of misunderstanding, he turned aside from the task of developing these ideas and tried again to tell the world what he really said, we should feel at worst sympathy, and regret for the creative work that has been lost.

The most important difference between Professor Chamberlin's theory and Mrs. Robinson's concerns the role of product differentiation. Professor Chamberlin accepts product differentiation as a fundamental characteristic of competition, arising from the differences between different consumers in tastes, personal characteristics, physical location etc. and from economies of scale. The grouping of a number of firms together, so as to illustrate the properties of competition, is treated as merely an expository device, which in the present volume he wishes to discard, though he does not work out fully the implications of this change in dealing with oligopoly and selling costs, which are considered mainly in separate chapters. Mrs. Robinson, on the other hand, retains the Marshallian concept of an industry and makes perfect competition a norm, treating the preferences of consumers for different sellers as essentially irrational frictions, breaking up an otherwise homogeneous market.

It is important to realise that this difference really is fundamental and significant. It affects profoundly the welfare implications of the theory; but it also affects its adequacy in summarising economic facts, since the concept of a homogeneous industry, fragmented by irrational preferences, covers at best a much smaller segment of our economic life than Professor Chamberlin's more general view.

Mrs. Robinson's picture of imperfect markets is not, however, as Professor Chamberlin implies, totally irrelevant. The fact that the products of different firms are commonly described by the same name, measured in the same units, and often given a common price quotation in market reports, strongly suggests that preferences within a group are widely regarded as different in kind from preferences between different groups. Where this is so, and where the group of competing products has a common cost structure, the situation does approximate, at least in the short run, to that of Mrs. Robinson, which is much more similar than Professor Chamberlin now admits to his own artificial model. This model, though adopted explicitly as a heroic abstraction, and as purely an expository device, was also claimed to apply more or less accurately to certain fields, notably retailing.[5] In this, and closely related fields, the two theories have become seriously confused. And the confusion has had serious consequences in the imputation of unwarranted welfare implications to Professor Chamberlin's more general theory, the misinterpretation of the theory as one of the short run only, and the illusion that full-cost pricing practices are inconsistent with it.

The welfare implications can be discussed under two headings: the theory of exploitation, and the theory of inefficiency, or wastes of competition. In both,

4. Chamberlin, *Towards a More General Theory,* p. 9, footnote 10.

5. Chamberlin, *The Theory of Monopolistic Competition,* p. 83.

Professor Chamberlin has been mainly the victim of misfortune, yet in neither can his theory be completely acquitted of contributing to the prevailing confusion.

In section II we shall discuss the implications of monopolistic competition for welfare analysis under the first heading, first with the assumption of a fixed number of products and later without this assumption. In section III we shall turn to the alleged wastes of competition and Professor Chamberlin's contribution to this important group of questions. Section IV will be devoted to discussing the relations between elasticity, time and the number of firms in Professor Chamberlin's theory. Section V will discuss briefly the full-cost principle of pricing and other matters covered in the book.

## II

The ideas of monopolistic and monopsonistic exploitation were Mrs. Robinson's[6] creation. Modern welfare analysis has profoundly modified their significance, though they are often still erroneously used without much modification, for example, in labour economics. Monopolistic exploitation of a particular kind of labour has no necessary tendency to reduce the real income of that kind of labour except in so far as it reduces the total national income. If the labour's product is a wage-good, for which the monopoly is due to irrational preferences only, the price of the product will be higher than it would be in the absence of this preference, and this will lower real wages. Similarly if the demand for such labour to make the monopolised product is a large proportion of the total demand for such labour for all uses, the falling off in demand for it as a result of the monopoly will probably reduce its price more than the rise in demand elsewhere — through displaced purchasing power — will raise it, and hence wages will probably fall. In other cases it is misleading to suggest that labour earns less as a result of monopoly, though it earns a lower proportion of the value of its own marginal product, because the marginal product is raised by restriction of output.

There is even no guarantee that labour working for a monopsony will earn less than if its industry were made competitive. We cannot simply assume away the monopsony. If, for example, the demand for labour in a mining area becomes more competitive because of improved transport conditions, this will introduce new employers to whom the labour could go and new labour that could come to the mine. The net effect on the price of local labour will depend on whether the mining area has surplus labour like South Wales in the nineteen thirties or labour shortage like Brunei today. Labour will get a larger proportion of the value of its marginal product, in either case, than before. But this will not necessarily mean a higher wage. We can probably say that frictions which generate monopsony tend to work against hired factors (not only labour) but not that they always do so.

Professor Chamberlin has made the point that with a falling demand curve the factors cannot all be paid the value of their marginal product, because the total product would be insufficient for this. If, however, the marginal product of enterprise is virtually zero, and if it earns the same normal profits as under pure competition, there is a sense in which other factors are exploited for the benefit of enterprise. The critical question is whether the extra units of enterprise corresponding to increased diversification do really yield some additional product. Professor Chamberlin argues that they normally do, because monopolistic competition is the result, not of an irrational fragmentation of an essentially homogeneous market, but of diversity of human tastes and locations, and economies of scale.

6. Robinson, *op. cit.*

Yet even if the concepts of monoplistic and monopsonistic exploitation are politically motivated oversimplifications, this is by no means all that can be said about the welfare implications of monopolistic competition. Whenever price differs from marginal cost the situation cannot be a welfare optimum. For it is always possible (in principle) to make some people better off without making any worse off. In order to elucidate this we may divide the question up into two stages. The first (suggested to the present reviewer, in correspondence, by Professor Samuelson) is to postulate a given number of products, i.e. take the degree of diversification as given, and examine the welfare implications of a situation in which this diversification has led (through economies of scale) to a situation of monopoly for each product. We may assume also that initially profits are normal, though of course such a situation would usually have been reached by earlier changes in the number of separate products, each produced by its own entrepreneur. In this situation prices are above marginal costs, and there will therefore be, for each product, buyers who are excluded from buying who would be willing to buy at a lower price that is still greater than the marginal cost. It would therefore pay both the seller and these particular buyers if such sales could be made, while existing sales remained unchanged.

The possibilities of this, and the welfare implications of the difficulties that arise, will be explored first within the limits of a fixed number of products. Later we shall relax this assumption.

Any sales below the price originally charged will imply discrimination if the original sales are to be maintained. Such discrimination is only possible if the market can be broken up, and if the elasticities of different consumers can be known. But if this is possible, discrimination can probably be carried further.[7] Buyers whose natural preference or situation approximates to that chosen by the seller gain an advantage in consumers' surplus at the expense of those whose preferences or situations are either flexible or located between different sellers. A firm which discriminates in price against the former and in favour of the latter will normally be able to extract a substantial proportion of the consumers' surplus which results from its setting up in business.

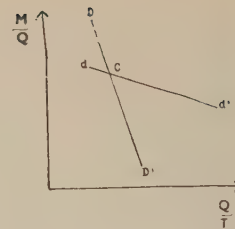
An optimum position could only be achieved if the seller could discriminate completely, making price equal to marginal cost, *for the marginal unit* for every buyer. Such a position would not be unequivocally better than the one with more limited discrimination, since although the gains to the seller plus those to the new buyers must be greater than the buyers suffering discrimination could afford to buy off by a bribe, the distributive effects might be unfavourable.[8] It would, however, probably be an improvement in the absence of undesirable distributive effects.

We must turn next to consider the effects of such discrimination on other sellers, and on the structure of the group, relaxing the assumption of a fixed number of products. In our first example of discrimination it was possible for the additional buyers attracted by discrimination to be people who, without such discrimination, would buy no close substitues of the product at all. Indeed, unless such buyers could be found, it would be difficult for our assumption of a fixed number of commodities to be strictly observed. With thoroughgoing discrimination the assumption must be relaxed, and we must also accept the possibility that discriminating monopolists will encroach on one another's markets.

7. Cf. W. A. Lewis, *Overhead Costs,* London: Allen and Unwin, 1949.

8. Cf. I.M.D. Little, *A Critique of Welfare Economics,* Oxford University Press, 1950, Ch. VII; T. de Scitovsky, "A Note on Welfare Propositions in Economics," *Review of Economic Studies,* 1941.

If we take Professor Chamberlin's original diagrams of group equilibrium,[9] where dd′ represents the demand curve of any one firm on the assumption that all other firms hold their price constant at C, while DD′ represents the demand curve of each when all adjust their prices simultaneously, we must, to analyse discrimination, give different meanings to the curves.




Let dd′ represent the average gross revenue at each level of sales, when discrimination is practised to yield the maximum gross revenue at that sales volume; and let DD′ represent the average gross revenue that each firm obtains at any given output when it takes all other firms' patterns of discrimination as given, and when they have in fact an independent pattern of discrimination giving the same average revenue per unit as it has. Equilibrium will then require adjustment of the price level and of the number of firms (with profit maximisation, free and unlimited entry and no oligopoly) so that dd′ will be tangent to the cost curve (not shown) at the point where it is cut by DD′.

Now discrimination will inevitably make dd′ flatter, because a reduction in average revenue will be secured by cutting prices only to those with the most elastic demands. The resulting increase in demand will, however, be mainly a result of comparative price advantage. We cannot be certain that DD′ (for any given number of competitors) will lie further to the right, or be less steep, as a result of discrimination than in its absence. It seems, on the whole, probable that some buyers with elastic demands for an individual firm's product will also have elastic demands for all products of the group, and that some buyers with inelastic demands for an individual firm's product will have an inelastic demand for the group. As long as there is some correlation DD′ will be made less steep by discrimination. It is also probable that the income transfers associated with charging some buyers for their privilege of having goods as they like them. and using the proceeds to give price concessions to others, would tend to increase aggregate demand, by a process of evening out the advantages. This would tend to move DD′ to the right.

The flattening of the dd′ curve will tend to increase the average size of firms and bring them nearer to the point of maximum efficiency. This will tend to reduce the number of firms, though the tendency will be partly offset by DD′ (with any *given* number of competitors) becoming less steep and moving to the right. Discrimination in prices, by allowing price cuts at the margin, would mitigate the conflict between diversification and efficiency, to which Professor Chamberlin first drew attention.

Unfortunately Professor Chamberlin, whose welfare presuppositions are so much more suitable for the analysis of the effects of price discrimination where supply is concentrated and demand heterogeneous, has not given us any discussion of the problem. Mrs. Robinson's discussion of the matter, based on the assumption of essential homogeneity of the product, does not touch these more fundamental issues.

Yet if some of the "wastes of competition" are a result of uniform pricing to differentiated buyers, this is not to say that the haggling methods of the local bazaar are to be recommended. There is a well-known moral argument against such methods because of the lying and chicanery involved in the techniques of

9. Chamberlin, *The Theory of Monopolistic Competition*, pp. 91, 92.

assessing individual elasticities.[10] There is also an economic argument, based on the time consumed in the act of sale and the greatly increased complexity of accounting and management. But such arguments do not apply to free delivery, gift coupons, and other devices for making concessions that will chiefly benefit the marginal consumer. Professor Chamberlin's techniques would be admirably suited to exploring the theory of such selling devices, and providing a focal point for still further ranges of marketing studies.

III

We may turn next to the other misinterpretation of the welfare aspects of Professor Chamberlin's theory, the attribution to him of the view that monopolistic competition is wasteful in comparison with a more competitive ordering of society. In the present volume he takes serious exception to the association of his own work with Mrs. Robinson's fundamental criticisms of capitalism, in which Marxist analysis is mingled with a criticism of the wastes due to elements of monopoly. A careful reading of *The Theory of Monopolistic Competition* supports his contention that he was not attempting to argue that monopolistic competition was needlessly inefficient. There are, however, a number of phrases which so strongly suggest a criticism of monopolistic competition, that it was almost inevitable that they should be confused with Mrs. Robinson's criticism of elements of monopoly in the capitalist system as set out in her *Economics of Imperfect Competition*. The following are examples:-

> "The effect of monopoly element on the individual's adjustment . . . is characteristically to render his price higher and his scale of production smaller than under pure competition." (Chapter 5, Section 2).

> "The output bears no relation to the most efficient scale of production revealed on the lowest point of the curve of production." (*Ibid.* three pages later).

> "If there were no monopoly elements, prices would correspond to the price of production under the most efficient conditions." (Chapter 5, Section 3).

Professor Chamberlin's actual thinking in the matter is probably best summed up, however, in the following quotation:

> "The equilibrium adjustment becomes then a sort of ideal. With fewer establishments, larger scales of production and lower prices it would always be true that buyers would be willing to pay more than it would cost to give them a greater diversity of product; and conversely with more producers and smaller scales of production, the higher prices they would pay would be more than such gains were worth."

It is hardly surprising that the concept indicated in the first three quotations should have attracted more attention than the far more difficult concept which follows, especially as the expression here happens to be rather involved — no doubt because the author was trying to be exceptionally careful in stating one of the key points of his theory. There can be little doubt, however, that monopolistic competition as "a sort of ideal" is much more compatible with the rest of Professor Chamberlin's analysis than the idea of "the wastes of competition." Had Mrs. Robinson's book not appeared in the same year, it is probable that the emphasis in both technical writings and textbooks in this general field would have been less hostile to the elements of monopoly which arise inevitably from economies of scale when human tastes or locations are naturally diverse. Yet Professor Chamberlin's own work probably enhanced its reputation by the sharpness of the paradox

10. Cf. K. Boulding, *Economic Analysis*, New York: Harper Bros., 1955, p. 36.

set out in some of these quotations from Chapter 5, and it is hardly legitimate to take too much exception to the fact that they have been confused with very similar analysis from Mrs. Robinson's book.

Lower costs can be secured by more standardisation in demand. In many cases increased standardisation of the product would be possible if there were some discrimination in prices charged, so that those with the highest elasticity of demand would be charged the price nearest to the marginal cost for the entire output of the product. But the conditions in which such discriminaion is compatible with efficient marketing techniques are probably rare and the fixed price system has other merits. Nevertheless, there are wastes associated not directly with product differentiation but with the price policies which inevitably result from it; and even those who feel, as this reviewer does, that Professor Chamberlin is nearer to the heart of the matter, must recognise that the techniques for the analysis of this problem have been provided not by Professor Chamberlin but by Mrs. Robinson.

## IV

We may turn next to Professor Chamberlin's complaints of the almost universal assumption that the phenomena of monopolistic competition are entirely short-run phenomena. In this sphere the theory at present seems to be in a state of great confusion, some of it probably due to misunderstanding of Professor Chamberlin's original ideas and confusion between them and those of Mrs. Robinson; but this confusion has probably been aggravated by Professor Chamberlin's own attitute to controversy.

First, Professor Chamberlin's own theory is not a short-term theory. In a sense the individual equilibrium of each firm can be regarded as short term (because the number of firms is conceptually held constant). But there is only a superficial suggestion in his analysis that the equilibrium comes about in two stages, an adjustment of each firm's prices first, and then an adjustment of the number of firms to the profits so generated.

It seems probable that this analysis would not have been treated as a short-term phenomenon if Mrs. Robinson's treatment, so much nearer in its presuppositions to Marshall, had not appeared at the same time. Yet it is now treated by many as a theory in which the short-term equilibrium of the firm is broadly correct but the long-term adjustment among the firms is something which has been proved wrong.[11]

To the present reviewer such a condemnation of the theory seems false; yet Professor Chamberlin hardly gives enough credit to certain criticisms which demand a fuller answer. The effect of changes in the number of firms on the elasticity of the individual firms' demand curves, and the sense in which prices of different products can be equated to one another, in particular, deserve fuller and more sympathetic treatment.

When Professor Chamberlin introduced the idea of group equilibrium he treated firms as having both similar cost curves and demand curves of similar slope. As new firms entered the group the demand curves of individual firms moved to the left, without changing their slope. As all firms simultaneously cut prices these demand curves slid down the main DD′ curve, again without changing their slope. In the present volume, although there are fewer diagrams, assumptions of the same kind seem to be made.

11. The relation between competition among existing firms and the entry of new competitors is thoroughly explored in R. F. Harrod, *Economic Essays*, London: Macmillan, 1952, Essay 8.

Now it is not self-evident that if one firm cuts prices its rivals' demand curves will simply move downward with unchanged slope; and it seems most unlikely that an increase in the density of firms will leave the slope of their demand curves unaffected. At least there should be more investigation of the different possibilities.

One possibility that merits consideration is that the *elasticities* of demand curves will remain unchanged as their position changes. Empirical studies of market demand curves, using the concept of a constant elasticity, have had some success. If the same condition applied to the demand curves confronting individual firms, then one firm's price would not vary with variations in its rivals' prices (or with the number of its rivals) provided it had a constant level of marginal cost. This is by no means an implausible assumption under conditions of excess capacity.

The proportional mark-up added to marginal cost is equal to $\frac{1}{|e| - 1}$ multiplied by marginal cost where e is the elasticity of the individual demand curve. Hence under conditions where the number of firms, or the prices of rivals, are changing, the change in the price charged by any given firm will depend either on the change in its marginal cost or on the change in the elasticity of its demand curve.

The U-shape of the average cost curve depends, in the main, on the adaptation of fixed factors to a certain scale of output, giving higher costs below the optimum output because the cost of fixed factors is spread over fewer units, and higher costs above it because of rapidly diminishing returns. Professor Chamberlin argues convincingly that it is a useless tautology to attribute this structure solely to indivisibilities in factors of production; nor is the distinction between fixed and variable factors solely one of time. Both indivisibilities and time factors play a part. But the important point at this stage of the argument is that the nature of the cost curve makes it almost equally probable that marginal costs will be falling slightly as that they will be rising slightly, when there is a good deal of excess capacity. An assumption of constant marginal costs, broadly corresponding to direct costs, or prime costs, will not be far wide of the mark in such conditions. The mark-up will then depend on elasticity.

Now if time is introduced explicitly into the picture we can enquire what happens to the demand curves, and the way in which they change, as the time under consideration is lengthened; and similarly what happens to the shape of the cost curves.

It is reasonable to assume that as the time under review is lengthened, the elasticity of the individual demand curves is increased within certain limits. No one would presumably deny that a price-cut may take some time (with rivals' prices unchanged) to attract all the sales that it is going to attract. Professor Chamberlin argues, however, that there is no factual basis for the assumption that, given sufficient time, these demand curves become infinitely elastic. In this he is surely right. The correct adjustment for an individual firm, in the absence of oligopoly, becomes a compromise among several different elasticities and is no longer even in principle a simple response to one demand curve. But it remains monopolistic competition.

Time has an effect on the elasticity of the demand curves. It also has an effect on the changes in demand curves that occur as a result of price changes elsewhere, or changes in market structure. If we allow time for a price-cut by a firm's rivals, its own demand curve may be further to the left but also less elastic, because the more volatile customers have had time to go elsewhere. But the essential point is that although time does affect the responses, and make them more complex, it does not affect the basic theory of monopolistic competition.

If it be conceded that elasticity does not become infinite with unlimited time, we have still to consider whether, in either the short or the long period, we can safely assume that the elasticity of the curves of individual firms' demand increases as a result of reduced prices by rivals or increased density in the market. For unless this occurs, price is determined by marginal cost and by the given elasticity, and adjustment takes place wholly by adjustment of numbers, and not at all by price-cutting.

On the whole it seems probable that elasticity increases with increased density in the market. The individual demand curves of all sellers will be moved to the left by the entry of new firms, and there will not be a corresponding increase in their slope, such as would be needed to keep elasticity constant. For, with an increase in the number of sellers in a given area it is difficult to see how a given absolute cut in price should attract a smaller absolute amount of sales. Indeed one might expect the absolute increase in sales to be greater because of closer competition. This would suggest that the individual demand curves should actually grow flatter as they move to the left.[12]

We cannot so easily establish that a price-cut by a rival will increase a firm's elasticity of demand as it moves the curve to the left. It will of course reduce the firm's profits, but there may be no tendency to cause a price response unless elements of oligopoly enter in, based on the notion that certain prices of different firms are equivalent, and that price competition must be matched.

As for the effect on the shape of the cost curve, it seems more probable on the whole in the long than in the short run that there will be economies of scale (at outputs less than full capacity, if full capacity exists) and that these will go beyond those of spreading a fixed cost over more units. So far as this goes, it would mean that, unless a rival's price-cut increased the elasticity of a firm's own demand, its own best response would be to raise prices; since with unchanged or reduced elasticity there would be an equal or greater proportional mark-up on an increased marginal cost, as output was reduced.

This would tend to suggest that price rivalry is more associated with oligopoly than with monopolistic competition in the large group.

Professor Chamberlin does not, however, explore in detail the effects, on his theory of oligopoly, of his abandonment of the group concept — which appears to have been motivated principally by the desire to avoid confusion with Mrs. Robinson's analysis based on an industry. He pours scorn on the notion that equivalence of prices is meaningless so long as "differentiation of product is, as claimed, essential," but this criticism is by no means absurd in oligopoly situations.

Perhaps it is an exaggeration to call it *meaningless* except in the modern esoteric meaning of meaning in which the question "Does God exist?" has no meaning. In the ordinary sense of the term, equivalence of prices does convey a meaning to us. But is it any use? It may not be meaningless to say that a pound of coffee and a theatre ticket sell for the same price; but it conveys a false impression of what a price is. The dimensions of a price are $MQ^{-1}$; and normally the equivalence between the price per pound of coffee and the price of theatre tickets per ticket would be no more use than, say, the fact that the price of petrol in Singgora was the same as that in Penang, the former being measured in ticals per litre and the latter in dollars per gallon.

12. I have discussed this more fully in Essay 6, "Advertising Costs in Monopolistic Competition," in J. K. Eastham, *Dundee Economic Essays,* London: Economists' Bookshop, 1955, pp. 92 — 93.

Measurement implies some degree of homogeneity in the things measured. Fresh peas and frozen peas are substitutes within a given group. Obviously the price per pound, including shells and cardboard containers in the weight, is not very significant for comparison. But if we compare costs per pound of edible pea we must face the fact that the cost of removing the waste is not the same for both, that it differs for different people, and is affected by the amount bought at one time. If these differences are significantly variable as between different customers, there will be no one weight of fresh peas which is equivalent to a pound of frozen peas, and hence no equivalent price.

Professor Chamberlin's analysis of oligopoly rests heavily on the concept of equivalent prices. But if, for any substantial number of people in a market, two prices of different goods are equivalent, we cannot rule out the possibility of a large number of marginal buyers[13] who will buy at whatever price is cheapest, so rendering the smooth demand curve of the individual firm improbable. It appears, therefore, that further clarification will still be needed on the significance of equivalent prices.

## V

The confusion between Professor Chamberlin's theory and Mrs. Robinson's has also, as Professor Chamberlin claims in this volume, led to an exaggerated belief in the inconsistency between the full-cost principle in price policy and monopolistic competition.

But before discussing this we must first set aside Professor Chamberlin's unwarranted claim that under imperfect competition price policy is wholly identified with profit maximisation, whereas under monopolistic competition it is not. Mrs. Robinson and Professor Chamberlin both use profit maximisation consistently in analysing the behaviour of the individual firm, and both give, sufficiently carefully, reasons why this is not a fully adequate treatment. Professor Chamberlin failed to appreciate adequately the use to which the marginal revenue curve could be put, within the framework of maximising profit. Mrs. Robinson's work has successfully popularised this useful technique, and it is now used in textbooks to explain points that were less clear in Professor Chamberlin's own analysis. His subsequent attempt to belittle the concept, and to suggest that profit maximisation played a relatively small part in his own analysis is one of the less pleasant features of this controversy.

It is, however, true that because of its treatment of product variation and market structure, the *Theory of Monopolistic Competition* contains much more that is relevant to pricing policies based on other principles than Mrs. Robinson's book does. Many of Professor Chamberlin's points, made incidentally in a chapter mainly devoted to proving the consistency of full-cost pricing with his own theory, give insights into the relation between full-cost pricing and market structure which are much more valuable than the wooing of Messrs. Andrews, Hall and Hitch and the customary damning of Mrs. Robinson, that make up too large a part of this chapter.

The book contains a number of other chapters, largely unrelated to the main theme, which are of very uneven quality. The erudite and amusing chapter on the origin of oligopoly is a fascinating curiosum. The experimental imperfect market, here made available to a wider public, will be a useful teaching aid to many. The less said about the chapter on labour the better. Neither the argument itself nor the footnote with which it concludes will enhance the author's reputation. It would be inappropriate for the present reviewer to comment at all fully on the chapter on Advertising Costs and Equilibrium, though it is possibly

13. Chamberlin, *Towards a More General Theory*, p. 15, footnote 23.

more intelligible to him than it is likely to be to the average reader, in the absence of the other articles in the controversy.[14]

All in all, this is a disappointing book. Economic theory still lacks adequate investigation of the relations of individual firms in markets. Professor Chamberlin's techniques unquestionably provide the best tools to use in such an investigation. He has given us one chapter which notably widens and deepens our understanding, a few brilliant insights which remind us of the revolution introduced into all our thinking by the *Theory of Monopolistic Competition,* and many jets of controversy which bring a little light with much heat, a little vindication at the cost of a quarter of a century of the life of one of our leading economists.

14. The footnote with which it concludes is an interesting specimen of Professor Chamberlin's controversial technique. For the record, it is sufficient to cite the following references, which show that the discussion concerned solely the technique of diagrammatic representation and that the present reviewer's intervention was primarily for the purpose of correcting the error now admitted in footnote 6 on p. 152: A. P. Lerner, "The Concept of Monopoly and the Measurement of Monopoly Power," *Review of Economic Studies* I, p. 173, 1933; H. Smith, "Advertising Costs and Equilibrium," *ibid,* II pp. 62-65, 1934; E. H. Chamberlin, "Advertising Costs and equilibrium, A Correction," *ibid,* XII pp. 116-120, 1945; T. H. Silcock, "Professor Chamberlin and Mr. Smith on Advertising," *ibid,* XVII pp. 34-39, 1947-8; H. Smith, "Advertising Costs and Equilibrium: a Reply," *ibid,* XVII pp. 40-41; T. H. Silcock, "Advertising Costs in Monopolistic Competition," in J. K. Eastham, *Dundee Economic Essays,* London: Economists' Bookshop, 1955, pp. 85-103. The last reference cited had been sent to Professor Chamberlin (note explanation on p. 95) before the chapter was reprinted.

# MALAYAN MONETARY PROBLEMS

By Sir Sydney Caine

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The recent articles by Messrs. Sherwood, Wilson and King,[1] following on the publication of the report by Mr. G. M. Watson and myself on central banking proposals for Malaya,[2] should help very substantially towards a fuller understanding of the basic considerations in framing the best monetary arrangements for the country. I should explain immediately that in examining the question I personally approach it as one involving an economic region comprising the two political entities of the Federation of Malaya and Singapore, whose economic fortunes are, and are likely to continue to be, closely interconnected, although their political development has to some extent diverged.

I have been asked to provide something by way of a summing up of the previous discussion. I want to concentrate on basic considerations and therefore begin with some examination of the background of monetary theory. The problems of a monetary system can, I suggest, be examined at three levels of development or sophistication. First, there is the provision of something serving the basic functions of money as a means of exchange and standard or store of value. Second, there are the refinements and developments of the basic monetary system designed to secure that there is adequate capacity for expansion of the money supply to meet the needs of a developing economy. Third, there is the problem of the conscious and deliberate manipulation of the money supplies as a regulator of economic activity.

The first of the traditional basic functions of money is to serve as a medium of exchange, that is, in the most primitive form, to enable goods to be exchanged without resort to direct barter by choosing an intermediary of a wide and ideally universal acceptability. Secondly, and obviously closely associated with this first function, money serves as a standard of value, that is as a unit in which price can be expressed. Thirdly, it serves as a store of value, that is, as something which can be put aside while retaining its value as purchasing power. We are apt today to take these functions for granted, but it is not to be forgotten that they can be jeopardised by mismanagement of money. Particularly is this true of money as a store of value. Obviously it can cease to serve that purpose if it is subject to rapid depreciation in purchasing power as a result of inflation of the monetary supply. There can be no doubt that the monetary arrangements of the recent past in Malaya have provided a monetary system which serves these fundamental or basic objects, and the need to safeguard these basic functions underlies the caution and conservatism which inspired the present structure and are most obviously reflected in the still prevailing practice of aiming at a minimum of 100 per cent external cover for the actual issues of currency.

1. P. W. Sherwood, "The Watson-Caine Report on the Establishment of a Central Bank in Malaya", *Malayan Economic Review*, II, 1, April 1957, pp. 23-34; P. A. Wilson, "Money in Malaya", *Malayan Economic Review*, II, 2, October 1957, pp. 53-66; Frank H. H. King. "Notes on Malayan Monetary Problems", *Malayan Economic Review*, III, 1. April 1958, pp. 30-41.

2. G. M. Watson and Sir Sydney Caine, *Report on the Establishment of a Central Bank in Malaya*, Kuala Lumpur, 1956.

When we come next to consider the monetary structure at the second level of sophistication and examine how far it is easily adjustable and expandable to meet the needs of an increasing economy, it becomes necessary to pay increasing attention to other forms of money than actual legal tender currency. In modern thinking the monetary supply includes and, indeed, becomes more and more composed of, bank deposits held by the general public as well as legal tender currency, and the efficiency of the money arrangements is therefore inextricably linked up with the banking arrangements. This is, of course, implicit in all Mr. Wilson's calculations of the total money supply and cases of cash deposits.

The position as it has existed in Malaya in the last generation or two may be described as a colonial position not merely in the sense that the currency of the country was dependent on the currency of the Metropolitan or imperial power but also in the sense that the whole economy was largely dependent on the economy of more developed countries including, but not confined to, Great Britain itself. The basic characteristic as brought out in Mr. King's analysis is that local money was available without limit against the deposit of sterling, but legal tender money could not be obtained any other way; the supply of bank money was similarly, although not so precisely, determined by the resources available to the banks outside Malaya. Ignoring the element of elasticity resulting from variations in the banks' credit policies, it has been very nearly true to say that no addition to the local money supply could be made without an increase in the deposit of sterling against it, and it is this which has led to criticisms that the system has been unduly restrictive of expansion.

Certainly it would seem *prima facie* that such an arrangement does impose a burden on a developing country, since it would appear that part of the resources which might otherwise have been applied to development have had to be applied to the acquisition of the mere media of circulation. In practice, however, the system has been nothing like as restrictive as it appears. It may be noted in the first place that up to quite modern times it was taken for granted that money would either consist of or be backed by the precious metals, and that in such a system it was inevitable that a country which needed more money as a medium of circulation had to acquire it by buying the necessary gold or silver. It is only since the widespread adoption of paper as a medium of circulation and of exchange standard systems as a substitute for the holding of bullion, that it has even appeared possible to avoid that necessity. That is, however, only an historic comment, and if it is true that 100 years ago any country was subject to that particular limitation on the ease with which it could expand its money supply, that is not necessarily a good reason why it should be subject to the same limitation today.

Much more significant, as regards the recent past in Malaya, is that because of the whole nature of the country's economic relationship with the rest of the world, the expansion of the economy has hitherto normally been stimulated by an influx of money from outside, so that the increase in the money supply necessary to sustain the higher level of activity has similarly been financed from outside. In detail, the outside financing of increased activity has taken the form either of the import of capital to finance new developments, or of an increased level of payments for local products (primarily tin and rubber) exported from the country. Whether the funds flowing in represented new capital or payments for local products, the part with which we are concerned is that which went as wages to plantation or mine workers or as payments to rubber smallholders. Normally, as such payments expanded, the initial increase in money supply would be provided by bank credits from outside Malaya, which would be used to purchase local currency for payment to people in Malaya. It would then be for the labourers or smallholders or the traders to whom they transferred their earnings in payment for purchases of foods, etc. to decide how much of the new circulation of currency they in fact wanted to hold.

At the end of a cycle of expansion the general public would be left with a certain amount of additional currency and no doubt a certain amount of additional bank balances. Against the additional currency the Government or, more strictly an agency acting on its behalf, the Currency Board, would be holding an equivalent amount of sterling on which it would be earning interest. The public in effect would be making an interest-free loan to the Government, and the Government in its turn would be investing the sum involved at interest so that the country as a whole could be regarded as having saved and put on interest-bearing deposit a portion of its increased income from overseas corresponding to the increase of legal tender currency necessary to sustain the new level of activity. The position with regard to the increase of bank money is similar in that the banks also would almost certainly be holding increased overseas assets against new increased local deposits, but the financial implications are not quite so clear cut.

The system therefore was nothing like so burdensome to the country as a whole as the first examination of it would suggest. No doubt some cost was involved in providing the additional money, both legal tender and bank, required by the higher level of activity, but the net cost was very small. Those whose inclination is to favour more and more expansion may argue that the resources coming under the control of the Government by the operation described could be better used to increase local investment in the public sector than to invest in interest-bearing securities in London. Whether or not that criticism may be valid in other circumstances, it would be difficult to sustain in application to pre-war Malaya, because there can be little question that in that period at least the Malayan Governments were not using their overseas borrowing capacity to the full, so that if they had desired to undertake increased capital expenditure at the expense of their liquidity position they could just as easily have done it by raising a public loan as by using part of the currency funds.

It is relevant to this discussion that the actual practice as it prevailed before the war strengthened the Governments' general financial position in two ways. First, the earnings of the Currency Board on its invested funds came in due course into the revenues of the Malayan Governments. Second, and probably more important, the assurance of monetary stability provided by the whole system unquestionably increased the credit worthiness, that is the general borrowing capacity, of the Government. It is not therefore at all unreasonable to suspect that the self-denial (at the time largely unconscious self-denial) of not using for immediate capital investment the resources coming under Government control as a result of additional issues of currency, may have increased rather than diminished the Governments' ability to finance new capital expenditure.

Another factor in the situation existing within the traditional monetary structure is, of course, the close linkage with the United Kingdom of all banks operating in Malaya, whether they have their head offices locally, in London, or elsewhere. This has ensured that the expansion of credit necessary to provide an expanding basis of bank money has been limited not by the availability of local funds but by the availability of funds in London. At least until the days of capital issue control in London that meant that for practical purposes there was no limit to the size of the reservoir of funds on which Malaya might call, although a check might be imposed by the price which might have to be paid in the rate of interest.

The question which must arise is whether all this is still true. While the impulses of expansion were likely to come entirely from outside, it might well be true that no significant local cost was involved in the provision of additional currency, and no check was imposed by the nature of the system to the expansion of the money supply needed as part of a particular operation of expansion. May

it, however, be the case now that what may be called indigenous impulses towards expansion are tending to develop, that is impulses purely local in origin and not dependent either on imports of capital from outside or increased sales of goods to outside buyers? That is, ought we now to take account of projects of purely internal development? Probably it is true that Malaya has passed out of the phase of a purely externally oriented economy, and particularly with the development of secondary industry the country should look to an ever-increasing element of purely internal development. If that is so, it may be the case that the traditional system may operate more significantly as a check to an expansion of the money supply complementary to the growth of economic activity, and that the cost of such expansion may begin to appear a real and not a purely nominal burden.

In such circumstances it becomes more reasonable to modify the system so that expansion of the money supply can be effected without sterilising exactly parallel resources, sterling or otherwise, as backing for it. Put in another form, it becomes no longer axiomatic good sense to hold full 100 per cent backing for the currency. I would not like to argue that it is by a process of reasoning of this kind that the authorities in London have re-assessed the position, but it is at any rate significant that for some years now the Colonial Office has been prepared to approve of a modification in the local currency practice to provide for the holding of a certain percentage of local government securities instead of sterling in London, so rendering possible an expansion of circulation without the necessity of sterling deposits.

It is what I have called the third level of sophistication — the analysis of of money as a regulator of economic activity — that occupies most of the Sherwood-King-Wilson articles. Broadly they all take what would be generally classed as a Keynesian approach. A very great deal has been written, and is being written about the precise meaning of the monetary theories of J. M. Keynes, about the extent to which they were novel or already formed part of earlier economic thinking, and about the extent to which they are applicable in different circumstances. I do not propose to attempt a summary of these discussions but only to look at the simple basic approach common to the mass of economists today who concern themselves with the effect of monetary management on overall economic activity.

This assumes an economic system possessing, at any given moment, a known quantity of 'factors of production' — natural resources, labour, capital equipment and managerial skill — and that the degree to which those means of production will be used depends on the demand for them. Demand in turn depends on how much money potential consumers (whether private persons, corporations or governments) have at their command. If existing demand is insufficient to call into operation the whole of the available means of production, the economy as a whole is under-employed; there will be some degree of depression and unemployment of labour. If existing demand is so high as to exceed the capacity of the means of production, there will be boom conditions, over-full employment in the labour market and conditions of strain and inflation. Variations in demand brought about by changes in the money supply can correct either extreme position and, if perfectly managed, maintain a state of full but not over-full use of resources.

To this simple statement there are an enormous variety of complications. There are 'multiplier' effects, i.e. the secondary increases of demand resulting from the increased incomes generated by an initial impetus on the demand side. There are imperfections in the ideal working of the mechanism if there is not a perfect balance between the different factors of production, e.g. if shortage of capital equipment or of land hinders the employment of all the labour available or if full

employment is reached in labour while there is still unused machinery in the factories. There are the effects of anticipations, e.g. the fact that in practice people's demands are influenced by the money they expect to have as well as by the money actually in their pockets or in the banks, that is, by their beliefs about their future incomes; and the fact that businessmen decide whether to expand or contract their own activities on the basis of their own guesses about what demand is going to be as well as what it is. Furthermore reactions do not depend simply on statistical calculations; they are greatly influenced by incalculable changes in attitudes towards saving and risk-taking.

There are also very important qualifications to the basic theory resulting from the impact of external influences. In particular, variations in total demand must affect also demand for imported goods and — unless there is control of imports — must therefore have repercussions on the balance of payments.

Finally, the theoretical mechanism only applies fully if all the factors of production react perfectly to monetary stimuli.

Some of these complications, and especially the last two groups, will need further thought in considering the Malayan monetary situation, but we may first look a little further at the ways in which, granted this basic concept of the way monetary influences act on the level of activity, conscious policy may come into play.

There are various devices by which money demand can be increased or decreased. A government can operate directly on demand in the public sector, and in modern times the normal range of government activities is so wide that the demand of the public sector is a substantial percentage of total demand. The government can also operate on the private sector of demand by increasing or decreasing the demands it makes on private money incomes, i.e. by raising or lowering taxes. Alternatively it can increase the overall money supply by the simplest device of increasing the quantity of legal tender money by printing notes without backing.[3]

The central bank can operate rather more subtly on the money supply by various devices. It can control or influence the rate of interest and thereby affect both saving on the one side and investment demand on the other. It can buy or sell securities so as to influence the free cash in the hands of commercial banks and other financial institutions. It can vary the legal or conventional requirements imposed on commercial banks as to the backing for their deposits, so varying the banks' capacity to 'create' bank-money by lending to their customers. Finally it can advance credits to the government direct.

It is around the role of the Malayan monetary authorities in these latter functions that the discussions of Messrs. Sherwood, King and Wilson have centred. Mr. Sherwood is the most critical both of the existing set-up and of the central banking mechanism contemplated by the report presented by Mr. Watson and myself; Mr. King is much less critical; and Mr. Wilson, though the theme of his article did not necessitate his taking any firm stand on this issue, would, I imagine, be nearer to Mr. King than to Mr. Sherwood. I find myself also nearer to Mr. King's than to Mr. Sherwood's position, not because I quarrel with Mr. Sherwood's logic but because I think he starts from certain false premises.

First, let us go back to the importance of external influences. Assume, as an extreme case, a country which sold *all* its production to foreign buyers and bought *all* its consumption goods from foreign suppliers.[4] In such an economy

3. Theoretically it can, if need exists, do the opposite and withdraw notes from circulation at its own cost, but that is a much less frequent operation.

4. Kuwait and other Arabian oil producers come fairly near that limiting case.

the demand which stimulates internal activity is entirely outside the control of the local government, while any creation of additional local demand would affect only external supplies. Obviously, there is room for all gradations between that extreme and the other extreme of a self-contained economy in which both all buyers of the country's products and all suppliers of its needs are internal.[5]

Malaya is midway in this gradation. The demand on which its most prominent industries depend is primarily foreign and not subject to Malayan monetary influence, while much of its consumption needs are met by foreign suppliers who, rather than local producers, would benefit by an increase in Malayan demand. On the other hand, there are substantial and growing lines of production catering for local demand. In other terminology, the propensity to export and the propensity to import are both high. In such an economy the power of local action to stimulate demand for the country's own products is low while, since a large part of any additional demand will be for imported goods, the danger of adverse effects on the balance of payments is great.

This situation means that local power to stimulate or damp down demand is substantially less than in more self-sufficient countries. The importance of external influences is emphasised by Mr. King and is a central point in Mr. Wilson's calculations of the way the money supply varies, but it is largely ignored by Mr. Sherwood who therefore tends to exaggerate the scope for deliberate policy in this field. An additional reason why that scope is limited is also emphasised by Mr. King, i.e., the fact that much of the banking of Malaya is still in the hands of branches of external banks. The credit made available by those banks is affected mainly by conditions elsewhere; it may be restricted by the policies of other countries but not easily limited by purely local action. In consequence, while there is some scope for local action to create new demand in a depression, the powers of local authorities to limit the availability of credit in a real boom are small.

It is tempting to meet this situation of close inter-dependence on other countries by insulating the Malayan economy from external forces. In theory the banking system could be cut off from its foreign connections by close exchange control and complete centralisation of external assets, and the dangers of undesirable effects on the balance of payments met by tight import control. Such isolation would, however, have incalculable results in the whole foreign trade position on which Malaya has lived and flourished in recent generations and I, for one, can see no possible advantages in the greater powers of monetary control resulting from such action which could offset the losses it would entail.

This is the more so for two reasons apart from more general considerations. First, although it is often argued that the fluctuations in price, etc., which Malayan products experience because of world trading connections have adverse effects on investment, I share Mr. King's view that there is in fact no evidence to support that thesis. If anything, the evidence (and some *a priori* argument also) points the other way. Second — and this is a consideration of wider significance in this field — we have to consider how far the Malayan economy is in fact subject to the stimulus of monetary demand. If there are unused resources, are these resources likely to be called into activity by higher demand?

Malaya is still a mixed economy, a country of plantations and mines, but also a country of peasants and fishermen. The plantations and the mines will respond readily to money incentives, but the response of the peasant is more dubious. Probably in Malayan villages, as in similar communities all over the

5. The U.S.A., in spite of its large external trade, approaches more nearly to the self-sufficient extreme than most other developed countries.

world, there is 'surplus' labour, i.e., not everybody is working quite to full capacity; but additional demand will not give the peasant more land to cultivate and, whether he would like to or not, he may not find it easy to utilise his surplus labour capacity. It is again necessary to recall that the demand for the products of plantations and mines comes largely from abroad; the production which meets a local demand is largely that of the peasant and other sections of the economy which are comparatively insensitive to monetary stimuli. There are two sectors of production which may be expected to show an 'orthodox' reaction to internal monetary policies, the production of services and the production of manufactured goods for local consumption. These are important and growing, but still only part of the total economy.

These are fundamental limitations on the scope of conscious policy. There are also more technical limitations on the immediate scope for action by a central bank because of the still embryonic nature of the Malayan money and capital market, which are sufficiently discussed in the Watson-Caine Report and in Mr. Sherwood's article. They serve only to reinforce the lesson that we must not exaggerate what a central bank might be able to do.

On the other hand there is a tendency to under-estimate what can be done to influence the money supply and effective demand by action in the budgetary field. As is clearly recognised by Mr. King, an effective "Keynesian" policy demands close partnership between the budgetary and the monetary authorities. There are many who think that in any country the Treasury is always in the end the dominant partner because, when used to the full, the budgetary weapon, although unsuited to the finer adjustments, is much the most powerful determinant of the level of demand. Whether or not that is always true, I am sure that it is true in Malaya. Far more in the way of anti-cyclical action can be done by wise adjustments of taxation and public spending than a central bank is likely to be able for many years to come to do by manipulations of liquidity ratios and operations in Malaya's narrow money markets. Mr. Wilson, followed by Mr. King, has drawn attention to another way in which the Government can influence the local money supply by the distribution of its own cash balances between local and external holdings.

Recapitulating, the most intellectually interesting and the most practically important issue in these discussions is the scope for conscious control of the money supply of Malaya with a view to maintaining a steady but high level of activity. The role of a central bank in such operations is limited by the main characteristics of the Malayan economy: first, its high degree of dependence on external trade; second, the fact that an important part of the economy which is purely internal in its operations is only to a moderate extent susceptible to monetary influences; and third, the comparatively undeveloped money and capital market.

There is, even in much more self-contained and sophisticated economies, a tendency to exaggerate the part to be played by a central bank in promoting development. The primary function of the central bank, as the main monetary authority, is to ensure the provision of a reliable basis for economic activity by maintaining the value of the money through which so much economic activity is conducted, and to see that the supply of that money keeps pace with the growth of the economy, that is, the discharge of the first two of the functions mentioned at the beginning of this article. By doing that and by elaborating the mechanisms through which savings are promoted and made available for investment, a central bank can perform a very useful service in providing part of the framework in which development can proceed.

But the mainsprings of development must be saving, investment and enterprise, private and/or public. The bank's functions are primarily regulatory and it can do little if there are no forces of that kind to regulate. If, however, the

forces of enterprise are strong enough and capital is forthcoming from savings, a vast amount of development can go on in the complete absence of a central bank. Mr. King has instanced Hong Kong, a very prominent example of just the kind of development which a central bank might be supposed to encourage, but without the benefit of anything of the kind. An even more prominent example is the U.S.A., whose tremendous development went on up till 1913 with no kind of central banking mechanism.

Against this background it seems to me that the Government of the Federation of Malaya is acting very wisely in the interests of the Malayan people in the recent decision to create a Central Bank with only modest powers and functions. Certainly some central mechanism can help over the years to improve the internal financial structure, but a slow start is much to be desired. It is especially welcome that the basis of the currency which serves the Federation of Malaya, Singapore and Borneo is, I understand, to be left unchanged. I do not conceal that I believe that any breach in the fundamental monetary unity of the Federation and Singapore would be seriously damaging to both and it is therefore good that, while the authorities in Kuala Lumpur feel it necessary to establish some central mechanism of their own, it does not seriously breach the regional unity and — I hope — leaves open the possibility of re-cementing that unity in the banking field at a later date.

Meanwhile the main initiative for development must come, not from false hopes of a new bit of machinery, but from the enterprise and savings of the private individuals and the policies of the Governments; and the main responsibility for damping down economic fluctuations, so far as they are not reduced by international action, must rest with budgetary rather than monetary policies.

# POVERTY, AND SOME SOCIO-ECONOMIC ASPECTS OF HOARDING, SAVING AND BORROWING IN MALAYA

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"Thus oppression in the extreme appears terrible, but oppression in more refined appearances remains to be oppression. . . ."
John Woolman (1720-1772), *A plea for the Poor.*

The mobilisation of domestic capital, as a basis for financing development from internal capital resources, has for long engaged the attention of economists in Western countries, in South and Southeast Asia, and in other areas of the Asian region.[1] The low level of economic welfare in Asia has been, and still is, a chief factor hindering enterprise and blunting initiative. An Asian delegate at the 1954 ECAFE Conference commented that:

> "We are poor because we continue to be poor. Poverty breeds disease and helps ignorance. Badly fed, poorly housed and under-employed, if not unemployed, the (Asian) people either accept their condition in a mood of fatalism or rebel against it."[2]

The amount of saving in the Asian region, as a fund for productive investment, is still disappointing. Everywhere, including Malaya, the "true" *per capita* income[3] is very low, in some areas lower than in others. The amounts that can thus be raised out of saving[4] are insufficient for financing economic development—

* I would like to express my gratitude to those civil servants and other persons — including my fellow lecturers in the Department of Economics, University of Malaya — who helped me in collecting some of the material for this paper, or discussed with me many of the related points. I would like to mention in particular, Ungku A. Aziz, Lecturer in Agricultural Economics; the Office of the Controller of the Postal Savings Bank, Kuala Lumpur; the Assistant Commissioner of Police, Singapore, B. W. S. Goodridge Esq.; Mr. R. Ramalingam M.B.E., Rural Board, Singapore; Mr. G. Kandasamy, the Executive Secretary, Singapore Trades Union Congress; and Mr. R. S. Nathan, Seamen Welfare Officer, Singapore.

There are also many Malay, Chinese and Indian workers, in towns and villages, who at various times told me some of their experiences in the battle against poverty. Nevertheless, the views expressed in this paper, unless otherwise clearly and specifically stated, are entirely my own.

"Malaya" and "Malayan" as used in this paper include the Federation of Malaya and Singapore — the area — and the people of both.

The Straits Dollar (M$) is valued at M$1 = £0.2.4 = US$0.33 approx.

1. See e.g., UNO, *Methods of financing economic development in under-developed countries*, No. 1949. II. B. 4; ECAFE, *Mobilization of Domestic Capital — Report and Documents of the First Working Party of Experts*, U.N. Publication, II. F. 2. 1953; UNO, *Process and Problems of Industrialization in Under-Developed Countries*, E/2670, ST/ECA/29, December 1954.

2. See also, G. Myrdal, *Economic Theory and Under-Developed Regions*, London, 1957, chapter 2, pp. 11-12.

3. This writer has often publicly pointed out that the national-income-per-head of Asian countries, in the usual loose manner repeatedly used by some Malayans, and in certain international publications is, from the viewpoint of socio-economics, a completely useless and seriously misleading measurement of economic welfare. See also, C. Gamba, "Wages in Malaya" in *Problems of the Malayan Economy* (Ed. Lim Tay Boh), Singapore, 1957.

4. See Appendix A, but consider also Appendix B.

even on a small scale. Asian raw materials have suffered several sharp drops in price, sharper than for prices of imported capital goods. Lower revenues have confronted all Asian governments resulting in the curtailment of planned economic projects and of social welfare schemes, thus adding to the economic, the political and social discontent of local populations. On the other hand, boom periods, while bringing about enhanced profits from export sales, did not benefit the Asian countries to the extent that one would have expected under the circumstances.[5] The present restriction scheme in operation in the Malayan tin industry, in the same way as the rubber restriction schemes of bygone days,[6] is in fact weighing heavily, not on the large, foreign, concerns with solid resources behind them, but on the small local units and particularly on their labour, many thousands of whom are already out of work. They are unemployed and have therefore become poorer. For the same reason some unemployment may be expected in the tin smelting works at Pulau Brani, Butterworth and Penang.[7]

An historical analysis would show that the Asian countries, while producing great wealth for their former metropolitan powers, did in contrast benefit little — both socially and economically — by colonial occupation. For instance, from the early days of this century up to date, Malaya has produced over 15,000,000 tons of rubber, worth approximately M$20,000,000,000. It has also produced, during the same period, approximately 2,510,000 tons of tin-in-concentrate, worth in the vicinity of M$6,266,600,000.[8] The social and economic benefits that have accrued to the country do not apparently square with the value of rubber and tin produced, and Malaya — with her lopsided economy — is still in serious need of social and economic improvements of every type, requiring many hundreds of millions of dollars. The plight of the Malayan rural folks, and the abnormally low standard of living of groups of manual workers in the urban areas of the Federation of Malaya and Singapore, offers a peculiar contrast to the wealth produced by them during the past half century. It is unfortunately only too obvious that one of the direct consequences of Western colonial occupation in Asia, is exemplified to a large extent by the present poverty of the Asian people.

Everywhere in the region, not including special groups — as for instance the Europeans, the higher Asian middle class in the Federation of Malaya and Singapore, and certain trading, Governmental and military groups outside Malaya — wages and salaries are inadequate and the deep cleft between the large lower and small higher income groups is most noticeable. Wages, more often than not, afford only bare subsistence below even what has been recognised as the "normal" low for the region.[9] The extreme poverty of the *kampong* (village) communities

5. For Malaya refer e.g., J. P. Meek's controversial but nevertheless most enlightening study: *Malaya — A Study of Governmental Response to the Korean Boom,* Data Paper No. 17, Department of Far Eastern Studies, Cornell University, April 1955.

6. For rubber see e.g., P. T. Bauer, *Report on a Visit to the Rubber Growing Smallholdings of Malaya,* London: Colonial Office, 1947. Also, by the same author, *The Rubber Industry,* London, 1948.

7. Federation of Malaya, Labour Department: *Report on a Pilot Survey of Unemployment held in Georgetown, Penang, during May 1957,* Kuala Lumpur, September, 1957.

If the findings of the Penang study are applicable to Singapore, in direct proportion to the population of the two areas, there would be approximately 65,000 unemployed (totally unemployed, casual labour and under-employed) in Singapore (at the date of writing this paper — June, 1958). In addition, on the same assumption, during the period of the next twelve years, on the average, over 3,000 boys and girls will reach the age of sixteen every month, or over 100 young people will be looking for jobs every day.

8. See: Malaya, *Rubber Statistics: Handbooks,* various years; Malaya, Mines Department: *Bulletin of Statistics relating to the Mining Industry,* various years; *Annual Report on the Mining Industry, for the year 1947; First Quinquennial Report, 1955.*

9. See e.g., Colony of Singapore: *Urban Incomes and Housing, A Report on the Social Survey of Singapore, 1953-1954,* Singapore, 1955.

of Malaya is well-known.[10] Yet their poverty is not nearly as severe as that of the village people in India, Burma, Laos, Cambodia, Indochina, Thailand, Indonesia and the Philippines.

In marked contrast to the swing of export prices, cost-of-living figures have moved upwards or have remained stationary, and dividends for all foreign investors have been buoyant.[11] It has been said that the inflationary pressure in the region has generally lessened. This suggestion has little meaning; statements on the economic situation of Asia cannot be fully accepted until reliable statistics are obtainable of profits, sales, earnings, transfers and remittances, and until *all* factors relevant to the Asian economic situation have been taken into account, including those of a political, social and psychological kind. This process of theoretical reassessment has only begun.[12]

Development and capital formation can take place with foreign help, with the savings of the people, or with both. The second alternative — under ordinary circumstances — is only feasible to a limited extent. There are a number of factors to be taken into account when studying the problem of domestic capital formation in Southeast Asia. Once it is agreed that inadequate earnings are the first and foremost reason for the inability to spend and to save, it can be said that capital formation in Southeast Asia is affected by:

1. The propensity to hoard,
2. The number and types of saving institutions,
3. The prevalent methods of taxation,
4. The misuse of idle resources,
5. The absence or presence and the efficiency of public lending agencies,
6. The cultural attitude of each social group towards the concept of work[13], money and saving,
7. The impact of Western (capitalist) practices on the Asian village economy,
8. The size of the public debt,
9. The size of foreign investors' profits leaving the area,
10. The size and character of remittances (i.e. whether these are in fact the difference between satisfied consumption and expenditure, or sums obtained through unsatisfied consumption, with a concomitant lowering of standards of living),
11. The effect of current restrictive practices, by foreign *quasi*-monopolistic interests, on the industrial and commercial development of the area, so that this may remain as dependent as possible on foreign exports,
12. The inability of new, independent governments to operate a central banking system free from the pressure of foreign interests,

10. For an interesting study on the Malayan peasant economy see e.g., M. G. Swift, "The Accumulation of Capital in a Peasant Economy," *Economic Development and Cultural Change*, Vol. V, No. 4, July, 1957. For rural poverty in Malaya see e.g., A. Aziz, *Some Aspects of the Malayan Rural Economy Related to Measures for Mobilising Rural Savings*, ECAFE, Paper E/CN.11/I & T/WP.1/L.18, 1951; also, by the same writer, a series of articles on Malay economic problems, *The Straits Times*, Singapore, February 28, March 1, 4, 5, 1957; and in the *Singapore Standard*, July 8, 1958.

11. See shares bulletins, e.g., Lyall and Evatt (Shares Department), *Fortnightly Shares Circulars* (private circulation), Singapore. Also, Zorn and Leigh-Hunt: *Manual of Rubber Planting Companies*, London, various years; Comtel Reuter, *Trade Reports*, Planters Service, Singapore, various numbers.

12. For a new approach to the economics of the under-developed areas see, G. Myrdal, *Economic Theory and Under-developed Regions, op. cit.* Also, to a lesser extent, P. T. Bauer and B. S. Yamey, *The Economics of the Under-Developed Countries*, London, 1957.

13. See also, C. Gini, *Patologia Economica* (in Italian), Pt. I, Chs. I and II, Vth Ed., Turin, 1954, for a study on the evolution of the concept of "work." Refer also J. H. Boeke, *Economics and Economic Policy of Dual Societies*, New York, 1953, p. 104.

13. The expenditure on international defence commitments, and
14. The cost to the people of Ministries, the Civil Service, the Army and the Police.

While some of these factors may have less weight in one area than in another, and some may not even be present, all operate whether or not foreign help is obtained. In some cases foreign aid may not be obtained *unless* some of these factors do operate. But even with foreign help, it can happen that capital formation is slow and inadequate, or that it produces some form of unbalanced development. For instance, there may be heavy emphasis on technological development and industrialisation, with little thought being given to institutional changes or rural development.

Capital formation has been discussed at great length, but a searching inquiry has yet to be made into these various factors, the results combined, and the *true* nature of the problem shown.[14]

It has been said that in the countries of Asia and the Far East, where population is increasing by about 2 to 3½ per cent. per annum or more, unless these are favoured by abnormal changes in their terms of trade, the usual rate of annual net investment of about 5 per cent. or less of the national incomes will not be enough to raise the per capita product of these countries from present levels. Such a low volume of investment requires to be stepped up if the national product per head is to be raised even at an annual rate of a modest 1½ per cent.[15]

The problem facing the region is thus based on the circular, hackneyed consideration that economic progress, in terms of rural development and industrialisation, is a function, among other things, of new capital formation, that capital formation requires the mobilisation of savings, that savings depend on earnings[16] and, therefore, that unless earnings are improved, it is difficult to promote economic progress independently of foreign loans. These loans in any case can never be of the magnitude to bring about a speedy noticeable change in the *ecfare*[17] structure. This is the orthodox line of reasoning.

It is possible however, to promote development independently of foreign loans. After all, the underdeveloped countries "....need foreign capital, not because it is impossible to industrialise without it, but simply because it is very painful to try to do so...."[18] In this case, of course, the key requirements would be, a) that patriotic, courageous, dynamic and statesman-like political leadership that would inspire the masses into accepting the initial "painfulness" of the process of development, and b) overall planning with appropriate socio-economic institutions.

However, through time, in their attempt to deal with a situation of poverty and want, the people of the region — more generally the rural communities — have worked out their own ways to facilitate exchange, to obtain cash resources and to safeguard their future in terms of wealth "put aside". But these ways, in fact, have become obstacles to the capacity of the economies to promote capital formation out of savings. The use to which much of this cash is still put is unproductive of ecfare. Debts are paid but new debts are thereby incurred. In the urban areas salaries, wages and earnings go to repay lenders and *rentiers*, un-

14. As an item of interest, it may be mentioned that a well-known European economist suggested that development in Singapore might have to wait until the pressure of unemployment reduced wages sufficiently to make local industries more competitive!

15. See also, ECAFE, *Economic Bulletin for Asia and the Far East,* vol. 1, no. 1, 1950 and Vol. II, no. 3, 1951; UNO: *Economic Development and Planning in Asia and the Far East* (Economic Bulletin for Asia and the Far East, Vol. VI, 3, November 1955).

16. See also, Myrdal, *op. cit.,* and Bauer and Yamey, *op. cit.*

17. Vilfredo Pareto's terminology for economic welfare.

18. W. A. Lewis, *Aspects of Industrialisation,* p. 22. Cairo: National Bank of Egypt, 1953.

productive consumers (by-product, originally, of the impact of non-indigenous, capitalist practices upon the indigenous village economy) who, often enough, send this cash away from the country in remittances, invest it in real estate, or use it for quick-return speculations. Little of this money finds its way into schemes of local national economic development.

This paper is presented with a twofold purpose: (1) To examine some of those local ways — in Malaya — by which the lower wage-earning, salaried and self-employed groups attempt to save, seek to borrow and find lenders of cash or its equivalent, without having recourse to what may be called orthodox instrumentalities, as for instance, credit institutions and savings banks; (2) To draw attention to the variety of problems in this wide yet almost virgin field of investigation, and thus to encourage further and more intensive research. This paper is *not* intended to be in any way a *complete* study on poverty. It merely attempts to outline briefly the economic reaction of a group under the influence of a socio-economic system not indigenous to it. In other words, it deals with the clash between two social and economic systems:

> "Two social systems, one of which answers to Western economic premises, while the other does not".[19]

Most of the present economic problems of the underdeveloped areas of Asia can be interpreted as the outcome of the clash — over time — of two such systems.

## HOARDING

In Asia one finds an unorganised money market comprising a variety of methods through which the individual can obtain cash advances. In a similar manner in which socio-economic and cultural environmental forces encourage ways to place aside varying amounts of cash or its equivalent, so they also encourage the development of local credit methods to meet the demand for cash. None of these methods help in any major way towards capital formation. In most cases they hinder it. Hoarding, borrowing and indebtedness are all part of the same problem — that of the severe poverty prevalent in the Asian region. The traditional ways assumed by hoarding, borrowing and indebtedness vary from area to area and according to the level of earnings of the group following such practices, but they are in all cases another indication of the presence of poverty.

One of the first reasons preventing speedier capital formation is the practice of hoarding. In 1952, the private gold hoards in some of the areas of the region were said to be approximately ten per cent. of their national income.[20] This hoarding continues today. It is not merely a store of money — paper currency and coins hidden away. It is more generally in the shape of gold trinkets and jewellery. In Malaya and Indonesia it includes also silver, particularly coins of old denominations — such as thalers, Mexican dollars and old Dutch guilders.

It is mostly in the rural areas that this hoarding takes place, and as long as the region remains basically a village economy, saving proper will be difficult to encourage.[21] And over ninety per cent. of Asia still lives in villages. At the same time, if this hoarded wealth were spent over a period of four or five years, it would only contribute about two per cent. or less of the total national incomes to capital formation in the region. "We are poor because we continue to be poor".

19. Boeke, *op. cit.*, Ch. II, p. 11. In Malaya the situation is made more involved by the presence, on the Asian side, of three socio-culturally differentiated groups — Malay, Chinese and Indian — living and working side by side. Of these, the first two are almost of equal size, but unequal in economic power.

20. UNO: *Measures for the Economic Development of Under-Developed Areas*, E/1986/ST/ECA/10, 1951, p. 35.

21. *Ibid.*

Village hoards are held in different ways. The Eastern Indonesian still uses hollow bamboos filled with coins and gold ornaments. These are hidden in the walls of houses or buried in the ground. Paper currency and gold pieces are kept in like manner.[22] The Chinese in Southeast Asia hoard in a variety of ways but mainly in gold ornaments. Solid gold dentures are often bought, and these are removed at death to pay for the high costs of the elaborate funeral ceremonial. Chinese women labourers, the so-called "red tops" from their peculiar headgear, are known to hoard by carrying currency in a bandage wound around their waist. There have been cases of accidents taking place, involving these women who, on being attended for treatment, were discovered to carry cash worth up to M$5,000. The rural Indians in Malaya, particularly the Tamil originally from the Madras Presidency, tend to hide part of their earnings in earthenware pots buried in safe places. Wherever possible they purchase gold ornaments. Small diamonds are often used as a dowry for girls about to be married. A Tamil wife will wear the diamond in the fleshy part of one of the nostrils, through a hole, similar to an ear-ring. The diamond then becomes the property of the family, not of the individual wearing it, but it may be disposed of in times of need — generally by borrowing on its value — by the husband as the head of the family. The amounts hoarded in this manner are separate from the savings remitted by these groups to their families in the land of origin.[23] The rural Malays, like the Indonesians, use a short length of hollow bamboo, called *tabong*,[24] for the purpose of hoarding and as a money-box.

During the 1951 boom, rubber and tin workers bought gold and silver ornaments from pawnbrokers. At the end of the boom, during June 1952, when earnings fell, they were pawning these articles in the same pawnshops where they had originally bought them. The pawnshop business was therefore increasing. At the same time, owing to the cessation of the war in Korea, the price of gold and of other precious articles had fallen. For example, the pawnshops were paying twenty-five per cent. less on the pawned value of gold articles, and reducing their advances on diamonds from seventy to fifty per cent. of their value.

In the region there are both social and economic factors encouraging hoarding. There is the fear that paper money and coins may lose value through inflation, while the price of gold, of other precious metals and diamonds, may remain relatively stable. But, as already shown, the hoarder may eventually find himself the loser. Religion is in some cases another factor. The tenets of orthodox Islam have been against the acceptance of interest as a reward for abstinence. This has been a retarding influence in villages with Muslim inhabitants, slowing down the development of a saving habit. But today, Malay school-children in Singapore and the Federation of Malaya do take part in Postal Savings Bank (PSB) schemes, in the same ways as their Chinese and Indian fellows.

Far more important in retarding the saving habit is, firstly, the low earning power of the people, and secondly, the inadequacy in the number of saving institutions and the ignorance of many people as to their true character and purpose, the slowness of the administrative procedure and the particular way in which savings have been invested by the Governments.[25] As already mentioned, earnings are very low. The village economy is not conducive to a heavy traffic of goods, nor does it encourage highly paid services. If the returns from commercial

22. *Ibid*, p. 302 (a).

23. See Appendix B.

24. In this case the name given to the container is *tabong pekak*. Refer also Swift, *op. cit.*

25. Refer e.g., Aziz, *Some Aspects etc., op. cit.*; see also, Federation of Malaya, Post Office Savings Bank, *Reports, and Accounts*, various years; Singapore Post Office Savings Bank, *Report of*, various years.

The bulk of such savings has been invested in the United Kingdom.

transactions (sales of rice, rubber, fish and fruits) and services (as labourer) are favourable to the villager, he will obtain a small surplus. However, as his needs are very sparse, he will not use this surplus to buy extra goods for himself. He will hoard the cash — as cash or as gold—using it probably at a future date, when his earnings will fall below normal. In fact the village situation is generally one of an outward flow of cash and thus, of eventual indebtedness.[26] On the other hand, the villager or urban labourer may forward the surplus to relatives (remittance money) even, if necessary, by a drastic cutting down of consumption. In some cases, the laws of inheritance, particularly with rural holdings, hinder efficient production and thus become another obstacle to increased saving. The fact that smallholders, under the law, cannot obtain extra land for rubber planting, has added to their already weak economic position. Furthermore, fragmentation and the renting of the farm for half of the produce—the *bagi dua* system[27]—also encourages poverty. The middleman-cum-lender who in rural Malaya may own the instruments of production and generally controls the sales of the produce, forces the grower (and the fisherman also) into a continuous cycle of indebtedness. Lastly, economic distribution is highly emphasized by racial distribution as for instance between the indigenous and non-indigenous groups. In such cases, saving becomes a function of the distribution of wealth, and the *rate* of saving depends entirely on the control exercised—directly and indirectly—by foreign, Western, and local but non-indigenous higher middle-class interests over the economic activity of the area.

## SAVING

In Malaya there are in operation various systems whereby cash is borrowed without recourse to appropriately regulated institutions. The borrowed money—particularly in the rural areas and among petty traders and urban manual workers—does not flow through such agencies as the PSB or rural credit instrumentalities. Paper currency is hidden in a variety of ways and disposed of as the need arises. In the urban areas the Chinese take part in so-called *Tontine*[28] or *Wui* ( 會 ). The Tamil have a similar system called *Kuthu* ( கூட்டு ).

### 1. TONTINE

The name tontine is the Westernised term for the Wui. It originated from Lorenzo Tonti—a Neapolitan banker—who in France, *circa* 1653, initiated a similar scheme to the Wui. This was a financial arrangement by which subscribers to a loan or common fund each received an annuity which increased as the number of subscribers diminished by death, till the last survivor enjoyed the whole income. This system was already known in China in historical times, under the name of "Ancestors Fund".

The tontine, as in operation in Malaya, is usually organised by Chinese of all provincial origins—but mainly those from Fuchien and Kwangtung—and their friends. It has lately been adopted by non-Chinese groups. Its participants are not protected by law even though written accounts may be presented by the organiser to the subscribers.

26. See also, Boeke, *op. cit.*, p. 69.

27. *Ibid*, p. 22, where this system is shown as applying to the rubber share-croppers.

28. "Money Associations" called *tsung-hwei* in Mandarin, *wui* in Cantonese, *huai* in Hokien and *fui* in Khek dialect. Tsung means sponsor and hwei means club. See also, e.g., Hsia Tung Fei, *China's Gentry*, Chicago, 1954, p. 233 (n. 5).

There are several types of Wui: Dragon's Head (龍頭會); Lottery Wui (搖會) Tender Wui (標會): Large Head-Small Tail (大頭細尾); Equal Shares (平頭平尾); Tu Kan (都幹). See also, Siew Kuan, "Tontine or Wui — Product of an Abnormal Society" (in Chinese), *Nan Chiao Jit Pao*, Singapore, February 22, 1949.

Examples of this system can of course be found also in the rural areas.

In the more common form, the first borrower is the organiser and the tontine will consist of twelve or more members, seldom less, and will operate on a monthly basis. The members must not be thought of as gamblers, though some may participate in a gambling spirit. They form a tontine because they consider it a "savings bank", but offering to those who invest their small savings a higher rate of interest than obtainable from the PSB. The tontine is also considered a less formal way to obtain a loan in times of need, rather than having to approach a professional moneylender who may require a collateral or impose an extortionate rate of interest.

At the beginning of each month the twelve members assemble at the organiser's residence to make bids. A member will offer to pay an interest rate which he can afford—M$1 for every M$10 share. Three dollars and more for every M$10 is quite common depending on the urgency of the borrower's requirements. The cash is then collected and handed over to the higher bidder. It often happens that members who are in urgent need of a loan may offer as much as M$5 interest for a M$10 share. Yet, after all the bids are known, the next highest bid may only have been one dollar.

The members who receive loans will not be paid interest on the money they contribute to the tontine, and the last borrower will not pay any interest at all. The borrower next to the last will pay interest only to one member, the next preceding to two members until the round is completed. Handbooks, called Wui Books or *Wui Poh* ( 會部 ), are sometimes issued for tontine with shares higher than M$10. In these books the organiser acknowledges the contributions received from the members. He may also provide the members with a statement of accounts or *Wui Tan* ( 會 單 ). Individuals may be members of several separate tontine at the same time.[29]

Before World War II the interest paid was already very high. In a M$10 tontine of forty members, a M$4 interest was not uncommon and even at the earlier drawings, M$3 interest was usual.[30] Today, interest rates are even higher. He who offers the highest rate gets the loan. The organiser will collect the subscriptions and may even get a fee called *teh poh* ( 地鋪 ) for bringing the subscribers together.

It would be incorrect to say that this system of borrowing must have little importance within the Malayan economic system. Between July 1953 and February 1954, the Singapore Police were called to clarify a number of cases of abscondment by organisers of tontine. The amounts involved came to a total of M$1,814,471.[31] Abscondments of this type still take place yet tontine continue to be heavily patronised.

There are two groups of people using this system: a very small one comprising persons whose desire is purely to appease a gambling instinct; and the other, comprising those who use the cash for productive purposes or as a consumptive loan. In the first group are the *nonya*[32] and other Chinese ladies in Singapore and the Federation of Malaya, who take part in tontine in the same manner in which they play *Mahjong* ( 麻 將 ) and *Koo Kiew* ( 車 九 ).[33] In the second,

29. Appendix C shows how a tontine operates. See also, *Singapore Standard*, July 18, 1953; C. J. Koh, "Hway, Chinese Loan Societies", *Malayan Law Journal*, Singapore, February, 1938.

30. C. J. Koh, *op. cit.*

31. See also, *Singapore Standard*, February 1954.

32. Ladies from the Straits Chinese group of Penang and Malacca. C. J. Koh, *op. cit.*, says that in 1938 nine out of every ten amah and three out of every ten nonya were members of tontine.

33. Mahjong is a game played with small tiles similar to dominoes. Koo Kiew is a game of chance played with a pack of cards of various colours. For several forms of gambling in Malaya see, e.g., C. T. Dobree, *Gambling Games of Malaya*, Kuala Lumpur, 1957.

much larger group are the persons in urgent need of cash—as for instance Chinese hawkers who use this method to augment their working capital, and petty shop-keepers who use it to obtain a cash loan for the purchase of stock and the expansion of premises. In this particular case the borrower will be willing to pay a definite rate of interest—to him relatively low—as he needs the cash to clear debts for which he would otherwise have to pay a much higher and probably varying interest rate to a moneylender.

Chinese servants, particularly the *amah*,[34] quite often take part in a tontine as lenders. In other words, they consider the tontine as a means to invest and expand their savings.[35] Intra-departmental tontine are known to be organised by Municipality and Government servants. It is difficult to say whether or not in these cases the system is a form of gambling.

2. KUTHU

The Tamil population and other Indian groups in Malaya have their own borrowing systems similar to the tontine. The one most in use is the kuthu. This may or may not involve the payment of an interest rate. In the first instance, the right of the members to borrow is determined by the throw of a set of dice or by casting lots. The organiser has the right to take up the first collection.

Indian *mandore*[36] and Indian moneylenders operate tontine and kuthu among those working under or for them, or among those to whom they have loaned money. The mandore-cum-moneylender is quite common. In some of these cases exploitation is quite clear. The employees or the members of the mandore's gang will join the tontine or kuthu in order not to offend the "boss". In the case of the mandore, the men fear victimisation and loss of the job, for in many cases the mandore collects the men's wages from the employer and pays the workers, and in him rests the power to hire and fire. In the case of the moneylender, those who join the kuthu or tontine do so under pressure for the repayment of out-standing debts. On the other hand, if tontine and kuthu operate within a group of equal status, they can be both a form of cooperation and a means of profit-making. On the death of a member of a tontine or kuthu, all his contributions are, in some cases, cancelled and, if he was a borrower, no claims will be made against his family or relatives. However the organiser's right to collect the first round is granted to him because, through the abscondment or death of a contri-butor, he may have to foot the bill.

During the period of the world depression, between 1932 and 1938, the kuthu was the means whereby Indian labourers put themselves into business and became ice-water sellers, hawked *kachang putch*,[37] or were able to operate a small stall at a street corner, or in the empty recess betweeen shopwindows, where they sold cigarettes by the stick or the ingredients for the chewing of betel nut. Similarly to many Chinese hawkers, the Indian disguised unemployed of present-day Malaya attempts to subsist on what he can eke out of these and similar types of enterprise.

The kuthu, with or without interest, is common among urban Indians in Singapore and the Federation of Malaya, and among lower-grade employees in the

34. Cantonese female servants.

35. This writer's amah has already lost a total of M $2,000 when the organiser of a tontine disappeared after having collected the members' contributions. Legal experts and the Police say that it is not possible to prove such a charge in a Court of Law as no written evidence is available. Furthermore, the persons involved are almost always not prepared to give evidence even when swindled of large amounts.

36. Foreman.

37. Dried peas. See also C. J. Koh, *op. cit.*

civil service. In the latter case it has been known for a participant to be willing to pay M$600 interest (p.a.) to obtain a M$1,000 loan. This type of money may be required for the purchase of a block of land in India on which the borrower would eventually settle on retirement from Malaya; or it may be required to clear the indebtedness through default of land-rent payment incurred by the borrower's family or relatives, again in India.

The kuthu is not the only way by which money can be borrowed without recourse to moneylenders. Indians on the estates of the Federation of Malaya make use of the "prayer for the cash box" dinners. Friends are invited to a meal. At the entrance of the building where the function is held, there will stand the host with a cash box. Each guest will place a sum of money in the box and his name and amount will be entered into a cash book. Any of these contributors, in their own turn, will be entitled to hold a similar dinner when in need of cash. For the purpose of encouraging large contributions, the first few contributors are so arranged as to comprise the wealthiest members of the group. The factor "face" then comes into operation. It would be a loss of face not to contribute as near as possible to the sum put in the cash box by these people. The aim is usually achieved. Raymond Firth mentions a similar feast in the case of the Kelantan (Malay) peasants.[38]

Another and similar type of ceremony is that of "child ear-boring" or *kadhu kuthu* (காது குத்து) and the "bangle" ceremony. In both cases religion and economics are harmoniously blended. It is usual, however, for the higher-income earners within the group to be able to afford these functions, while obtaining the cooperation of the poorer members. The latter can seldom pay for the dinner that must go with the ceremony.

Indian labourers also deposit savings with Indian businessmen, without requiring the payment of interest. The money can be withdrawn on demand. The transaction may or may not involve a book entry.

It is important to recognise the fact that these practices are general, and that they form an integral part of the life of many thousands of individuals, even among those who are quite well educated. These methods of borrowing are efficient and speedy, as well as easily understood by the people at all socio-economic levels. They do not involve the signing of papers nor any complex organisation. Furthermore, they rely for their operation and success on mutually accepted standards of honesty, and on trust between individuals, because they belong to the same class (the mandore and his men, a group of amah or petty shopkeepers), province or village (a group of Hainanese, some workers of Cantonese birth, some Tamil from Cuddalore or a group of Malayalee from Kerala), or caste, where this social aspect may still have some weight (as among the Nair group in Singapore).

Among the Boyanese working at the Turf Club, Singapore, and in the Tanglin area of the island where one finds a concentration of Indonesian labour, traces have been found of the so-called *jula-jula,* probably originating from Menangkabau.[39] This system is very similar to the kuthu. A number of persons pay so much a month to a common fund, and each in turn uses the total amount, without any interest rate being charged on the loan.

38. R. Firth: *Malay Fishermen — Their Peasant Economy,* London, 1946, p. 177.

39. See also, B. ter Haar, *Adat Law in Indonesia,* p. 134, New York, 1948. J. H. Boeke in: *The Interests of the Voiceless Far East,* pp. 81-82, Leiden, 1948, mentions "credit clubs" operating in various parts of Asia and Japan.

Institutionalised saving is gradually being better understood in the Federation of Malaya and in Singapore, but among the larger section of low-earning groups it still does not offer the security which is experienced in subscribing to tontine and similar systems, the cases of fraud notwithstanding. Tontine and kuthu are partly socio-cultural and partly economic ways of life well-founded in the minds of the people, and well-tried by generations of use in Malaya and in the countries of their origin.

In asking questions as to why greater use is not made of the PSB, quite often one receives the answer that it is too depersonalised, cold, formal, slow-moving; that the branches are too far apart and often one must go to the nearest town—many miles away—to deposit the cash; that the rural areas are still very badly served in all facilities that would encourage saving; that the system of withdrawals is cumbersome. One also obtains the impression that the PSB system is considered far removed from the environmental cultural background. It is undoubtedly looked upon as something new, and its "newness" is distrusted.[40]

The largest proportion of savings in the Federation of Malaya must in fact be "urban" savings. Rural Post Offices are few, and even if the villagers wanted to save, they could not do so because of their extreme poverty. What in fact they urgently need is credit.[41] The introduction of credit institutions in the future will have to be related to the points made in reference to the PSB, and the officials in charge will have to be trained to be far more than bank-tellers. They will require a very thorough knowledge of the ways of the people, particularly of those forming the village community. The expansion of PSB and the opening of rural credit institutions in the *kampong*[42] areas, will involve the cooperation of various organisations and the dedicated work of individuals. All this is part of the problem of the general economic development of the area.[43]

In some of the more remote kampong the influence of a money economy is beginning to be felt in its full force—and then not in a way beneficial to the villagers. Until recently many of the villages were practically self-sufficient and operated more or less on the basis of exchange. Today they need relatively large amounts of cash. Unless the moneylenders and the lending-shopkeepers are to be allowed to continue their operations, and kuthu and tontine to divert cash from more useful forms of investment, the people at the lower socio-economic level—the

40. For other criticisms see, Aziz, *Some Aspects etc., op. cit.*

41. "......An efficient system of rural credit is an essential part of the machinery required for the economic development of agricultural resources...." Commonwealth of Australia, Rural Construction Commission, *Fifth Report,* February 28, 1945; "....Any improvement in the agrarian structure must be accompanied by credit...." F.A.O., Center on Land Problems in Asia and the Far East, *Documentation,* Bangkok, 1954; "In under-developed countries the scarcity of suitable credit institutions proved to be as serious a handicap as the lack of funds for supplying adequate credit to agriculture." F.A.O. *The State of Food and Agriculture,* Rome, 1955; "Adequate financing would increase the supply of food and other farm products needed by non-farm people and for export. Likewise, it is essential that adequate credit be made available to conserve and market farm products on an economic basis....A national credit system adequate to meet the needs for establishing a sound agriculture, and the services associated with it, is essential to the development of the nation's economy...." Office of Foreign Agricultural Relations, *Report of the China-United States Agricultural Mission,* Washington, 1947.

Consider that if the poverty of the rural areas is left unconquered: "....then there is no room for the development of a national industry, dependent on the rural masses for the sale of its products. These masses lack the indispensable buying power....," Boeke, *The interests etc., op. cit.,* p. 74.

42. Village, group of hamlets, small group of huts.

43. See also Aziz, *op. cit.,* various, and by the same writer, "Land Disintegration and Land Policy in Malaya," *Malayan Economic Review,* Vol. III, No. 1, April 1958.

people of the rural areas of Malaya and Singapore must be (a) given the opportunity to expand their earnings, and (b) taught what "saving" actually means, before institutionalised saving can really operate with any efficiency, and thus contribute to domestic capital formation. One is not sure—even without taking the factor poverty into consideration—that the little that is being done at the present moment in rural Malaya has much usefulness.

In the rural areas of Malaya personal savings and savings from enterprises—business savings—are almost identical and it would require a great deal of well-coordinated research to discover where such savings are the one and not the other. The real point to be made is that the smallholders, *padi*[44] farmers and small vegetable growers earn so little that personal savings[45] are used in the enterprise allowing the individuals working within it merely to subsist, and in some cases not even that! Even by hard squeezing it is doubtful that anything more than two per cent. of the total national product could be obtained from this group in the form of savings.

## INDEBTEDNESS

### RURAL

The introduction—in the nineteenth century—of a non-indigenous controlled exchange economy in Malay village society brought about the development of a credit relationship between the native producer and the non-indigenous agent, with the latter holding the strings of the purse. This credit relationship applied particularly to every aspect of rural production and to all land produce. The increased need for money by the Malay did not however proceed *pari passu* with his increased production for the market. But, as long as no outside influences affected the relationship, the Malay could continue to live with his family, satisfying his frugal needs, and his indebtedness was not acute. However, a few years after World War I all this changed. Prices of international produce (e.g. rubber) fluctuated violently and dropped, unemployment rose, wages and earnings fell, loans were reduced but financial obligations remained. The previous balanced relationship between the Malay and the non-indigenous agent became upset. At this point the agent took advantage of the situation, and chronic indebtedness now began to characterize the economy of the rural folks.

The shopkeeper-cum-moneylender, and the merchant-agent, took advantage of the cash needs of the native producer, and granted him loans at exorbitant rates of interest—interest to be paid in cash or kind. The character of this indebtedness was very different from that of the previous period. The lender saw to it that the debt was difficult of redemption, so that eventually he came to have monopoly powers over the disposal of the produce and over the cultivator's land and even over his chattels.[46]

A variety of practices then evolved, to give the rural people that temporary respite which, in any case, meant only moving from the debts incurred in the past to the debts to be accumulated in the future. The mobilisation of rural savings

44. The rice plant.

45. See, Swift, *op. cit.*, for a description of the source of such savings among the Malays.

46. See also, Boeke, *Economics and Economic Policy*, *op. cit.*, pp. 311-312, for a similar situation in Indonesia pre-war.

Of course, to the kampong people, the practices of the Chinese shopkeeper-cum-moneylender, or Indian chetty living in their midst, were blamed for all their economic ills. The rural populations were unaware of the policies of the Colonial Government, planters, tin miners and agency houses, which were just as unhelpful to Malayan economic development, and kept the rural areas backward. Politically, the British system sought to keep the three racial groups completely separate from each other, offering to the Malays feudal paternalism in the backwaters of the kampong.

implies the presence of a relatively efficient economic system which grants appropriate facilities for rural production. This never was and still is not the case in Malaya. The position is made still more difficult by the inadequacy of institutions for financing rural money needs, and the consideration that it is in fact the urban areas, not the countryside, that benefit most from development in Malaya.

To day, the Malay farmer rarely has enough capital to meet his working and living expenses from one harvest to the next. The padi farmer, for instance, has for years been forced—at the time of sowing—to borrow in cash or in goods from the local shopkeeper, and to repay his debt, not in cash, but in padi after the harvest. Through time this transaction has acquired a recognised pattern, being known as *padi kuncha*,[47] or *jual janji*.[48]

(1) PADI KUNCHA

The farmer borrows a sum of money—say M$50—which he must repay eight months later by a kuncha of padi. Assuming a kuncha of rice to be worth at market price M$100, the interest on the loan will be 100 per cent. for eight months.[49] This system is also explained in another way. When the padi farmer needs money he goes to the shopkeeper and they agree on a padi kuncha loan. It is assumed that the farmer has a *sawah*[50] measuring ten *relong*[51] capable of yielding 20 kuncha at harvest time. He agrees to receive M$1,400 immediately in exchange for 20 kuncha[52] which he will deliver to the shopkeeper *after* the harvest. This will be a *viva voce* agreement. In fact, the shopkeeper will give the farmer only M$400 in cash, telling him that he will give him the remaining M$1,000 some time in the future. Between the time of receiving the M$400 and the harvest, the farmer becomes indebted to the shopkeeper for household goods and food, and he clears this indebtedness out of the promised M$1,000. This sum will be reduced, say, to M$700 which he will use partly to cover land-rent and, partly, again, to buy goods in the shop. On receiving the twenty kuncha of rice from the farmer, the shopkeeper, by having consented to take part in the deal, will at least have made M$700 profit—M$600 from the padi kuncha agreement (by selling the 20 kuncha at M$100 a kuncha), and about M$100 estimated profit out of the M$300 of goods sold to the farmer.[53] If consideration is given to the fact that most farmers must pay heavy rents to absentee, native, landlords, the main reason for their poverty becomes self-evident.

47. In describing in general economic terms certain rural features, this writer does not wish in any way to cross over the boundaries of his own specialisation (Labour Economics) into those of Malayan agricultural economics, for which his colleague and friend, Ungku A. Aziz, is the authority.

The kuncha is a small basket, and the name is also used as a measure of weight for straw, of about lbs. 1330. In this case a kuncha is equal to six piculs, lbs. 778.40 or kgs. 354. This system is often called *padi ratus*. Ratus means a hundred.

48. Jual janji means to sell subject to a condition.

49. See also, Federation of Malaya, Rural and Industrial Development Authority (RIDA), *Progress Report Up To 31st December, 1951,* Kuala Lumpur, 1952.

50. Irrigated field.

51. A relong varies between $\frac{7}{10}$ of an acre and $1\frac{1}{3}$ acres according to the locality. In Penang it is $1\frac{1}{3}$ and in Kedah $\frac{7}{10}$. In this case it is assumed that ten relong equal 13 acres.

52. Lbs. 15,568.

53. See also, *The Straits Times,* an article by E. Joseph, "Fighting the exploiters in the padi fields." December 30, 1951. Joseph points out that the farmers, at that date, in Kedah, were paying M $500 interest on a 30-day loan of M $1,000.

The padi kuncha system became less apparent when the RIDA[54] first began to grant loans to the padi farmers in 1951. By 1953 it was again in full swing and is still in operation today. The farmers, in this way, now pay in the vicinity of 200 per cent. interest (p.a.), if not more.

(2) JUAL JANJI

In the case of the jual janji, the owner padi farmer borrows a sum of money giving as security his padi field. The farmer may borrow M$1,000. The interest charged may be five *naleh*[55] of rice for *every* relong of land. After the harvest is over, the farmer will try to clear the accumulated interest to avoid losing his property. He then pays to the lender fifty naleh of rice (lbs. 5340), having still to repay the principal (M$1,000) which he has already fully used. The cash value of a naleh may be M$10 so that the interest on the M$1,000 loan is M$500. Furthermore, the rate of interest remains unchanged even if the loan has been received a month (or less) before the harvest.

It is clear that though certain loans have been made by RIDA, the problem of indebtedness of the rural people of Malaya needs urgent, specialised, handling. It is not the farmer that must seek the loan, but the *bona fide* lending instrumentality that must go to the farmer. This way of operating is quite common in Western countries and has brought about an assurance of stable and prosperous agricultural communities.

Since 1951, when the situation of indebtedness just described caught the attention of observers, the price of rice has hardly fallen due to the limited supply of rice, the population increase in the region, the uneasy political situation and the rice shortages elsewhere in Asia. More recent enquiries show, however, that the padi farmer is more indebted than ever.

It has been said that farmers and fishermen are extravagant types and that, like other kampong folks, at least once in their lifetime they want to go to Mecca for the pilgrimage; that they are fond of elaborate weddings and expensive *Hari Raya*[56] celebrations, and that they spend too much money on the various *kĕnduri*.[57] The Chinese farmer, it is suggested, wishes to celebrate his New Year—a period during which he must settle all his debts as well as give presents to relatives and friends, the *hung pao*.[58] He must also conform to tradition and have expensive feasts for weddings, births and funerals. While these cultural ways may press heavily on already overstrained budgets, which will eventually

54. See, *Utusan Melayu*, Singapore, September 24, 1953, cf. with the statement by the RIDA's Secretary, *The Straits Times*, Singapore, September 29, 1953. For RIDA see also: Federation of Malaya, *Scheme for the Reorganisation of the Rural and Industrial Development Authority, 1951; Progress Report up to 31st December, 1951; Progress Report from 1st January, 1952 to 30th June, 1952; Progress Report from January, 1953 to 30th June, 1953; The Rural and Industrial Development Authority Ordinance, 1953; Report on the Rural and Industrial Development Authority 1950-1955*, Kuala Lumpur, 1957.

55. One naleh equals 16 gantang of rice. One gantang is equal to one gallon or lbs. 6 2/3 of rice. Five naleh equal lbs. 534. See also, Joseph, *op. cit.*

56. Malay celebration, particularly Hari Raya Puasa, occurring at the end the fasting month.

57. Kĕnduri means religious feast. Hari Raya Puasa is the most important of such events. Kĕnduri arwah is the funeral feast. There are similar ceremonies following on the third, seventh, fortieth and hundreth day after the funeral.

58. Red packet. For information on Chinese festivals see e.g., V. Purcell, *The Chinese in Malaya*, Ch. VI, pp. 130-141, London, 1948. Paradoxically enough people short of money will borrow from pawnbrokers the cash with which to celebrate the New Year. For example, during the three or four days before the Chinese New Year 1952, the Singapore pawnshops accepted 30,000 articles worth over M $1,000,000. See also, *Singapore Standard*, January 1, 1952.

split at the seams, they cannot be criticized nor set down as reasons for poverty.[59] Poverty is already present before these cultural ways come into operation.

The need, more particularly in the case of the Malay rural folks, is for a sincere and long-term effort to aid the new generation by offering them an opportunity not to become indebted through exploitation—of the type of padi kuncha and jual janji. Therefore, they must be provided with fair returns for their efforts. *Poor returns, taxation, rack rents and indebtedness*, these are the four sets of conditions, in their order of increasing importance, under which the majority of the rural workers in Malaya—not only Malays—must operate. This, in any case, is still the situation in most parts of Western, South and Southeast Asia, including the Philippines. It is not a question of saying that the farmer must be encouraged to become more thrifty. He must be given an opportunity to expand his earnings; the shopkeeper must be stopped from lending money the way he does, from owning the instruments of production, from monopolising the means to dispose of the produce, from controlling sales, and from encouraging unproductive expenditure; the native landlord must be prevented from charging rack rents; and rural land values must not be allowed to rise above what is the socially just price. Finally, Government must plan for the village.

On the other hand, while the moneylender is an evil, in a country where the organisation of rural credit is as backward as in Malaya he does fulfil an economic function. Moneylenders have often been, and will continue to be—unless radical institutional changes do take place—a means for the larger smallholders to obtain cash for the advances they must make to their labourers. The removal of the moneylender woud not mean the removal of the root-cause of the smallholder's, farmer's and fisherman's troubles—lack of credit at the appropriate times—between crop harvests in particular.[60] The need is also for credit institutions suitable to the Malayan environment, not transplanted from elsewhere and, with a few changes, expected to operate smoothly and efficiently in the region. This lack of credit has been the tragedy of many similar situations elsewhere in Asia. Credit societies, cooperatives and the RIDA have all found difficulties in the way of their helping the rural worker. The problem, it should be realised, is not merely one of opening a new office or calling for foreign expertise. Nor is it that of thinking of a cooperative as another "shop" that must *not* compete with European Agency Houses, or of expecting it to be, in Malaya, a branch of the "Rochdale Pioneers". The problem is one of appropriate institutions, of dedicated officials and of far-reaching changes in the country's political, social, economic and institutional structure. Until such officials are at work in such institutions and within this framework, the lot of the rural worker in Malaya will not change, or will change slowly and painfully.

In his Report on the functioning of the RIDA, D. E. M. Fiennes has this to say:

> "The prosperity of Malayan towns depends on the prosperity of the Malayan countryside from which their wealth derives. . . . The social problem . . . is also important, and is in fact more likely to influence policy than any long term economic calculation. There is lack of balance between the town and countryside, which draws the intelligent

59. See also, Boeke, *op. cit.*, p. 51, last section.

60. The shopkeeper plays also an important part in the fishing industry. Similarly to padi farmers borrowing on their future crop, the fishermen borrow on their future catch. In both cases the shopkeeper becomes a monopolist and seldom does the worker obtain the benefit of rising prices. This system: "....tends very often to place (the fishermen) in the (shop keeper's) debt, with little chance of extricating themselves and building their own capital", Firth, *op. cit.* In both cases also, the shopkeeper strengthens his hold on the producer by monopolising the means of transporting fish and agricultural produce from the village to the town.

countryman to the opportunities of the town and deprives the countryside of many of its best people. And the agricultural community is itself divided into three nearly water-tight systems—plantation agriculture, the Malay peasantry and the resettled Chinese farmer. An increase in efficiency, bringing a more equal return to all sections of the rural population, will eliminate jealousy between the systems, and in the long run can lead to integration into a single agricultural system as a firm basis of national economy."[61]

While the divisions are not entirely watertight, and the plantation economy could more correctly be called that of the large, foreign-owned estates operating with wage-earning labour, the statement is nevertheless true and should already have given much food for thought to the proper authorities. It ought also to be considered that:

> "However much the moneylender may have exploited the borrower... he has fulfilled a need. In other words, he has filled a gap in an unsatisfactory credit structure. The only way to weaken his hold and, eventually, to supersede him, is to create an efficient rural banking system, or by offering satisfactory short-term cooperative credit."[62]

Professor J. L. Buck's statement on China is similarly cogent in the case of Malaya:

> "The problem....is not one of complaining about the high rate already charged but rather one of finding ways to tap and organize investment credit and devise an efficient system of extending credit to farmers."[63]

URBAN

It must be recognised that indebtedness in Asia is both chronic and cumulative. It is a feature of the disorganisation of the social structure; the effect of the economic dualism described in a previous paragraph of this paper. It is seldom fair and accurate to blame the individual for being in debt, or for becoming indebted. There may be cases where indebtedness could have been avoided. But the problem can only find its adequate solution through an examination of a combination of factors—economic, social and political. To consider the one, leaving the other two untouched, will not even explain, let alone solve the problem.

Low salaries and wages, and low earnings, have forced people to borrow from the *chettiar*,[64] the moneylender-boardinghouse keeper and the pawnbroker. The

61. *Report on the Rural and Industrial Development Authority, 1950-1955, op. cit.*, p. 5 (20-21). See also,, *The Straits Times*, an article by D. Fiennes: "Wherever a Malay may be, a little bit of his heart stays behind in the kampong", May 14, 1958. For the causes of poverty in the rural areas of Malaya see also, A. Aziz, "The Causes of Poverty in Malayan Agriculture", *Problems of the Malayan Economy*, (Ed. Lim Tay Boh), Singapore, 1957.

In writing this section one is perfectly aware of the various plans, reports and policies dealing with the Governments' proposed development measures for the rural areas of Singapore and the Federation.

62. F. J. Moore, "Money-lenders and Cooperators in India," *Economic Development and Cultural Change*, Vol. II, No. 2, June, 1953.

63. J. L. Buck, *Some Basic Agricultural Problems of China*, New York, 1947, p. 18.

64. The south Indian moneylender. Other Indian moneylenders are Punjabi. In fact among the higher Indian middle-class in Malaya, moneylending is a recognised business similar to banking. The Tank Road Temple, one of the most important Indian shrines in Singapore, is also called the Chettiars' Temple and its trustees are chettiars. Many Indian wage-earners deposit their savings for safekeeping with the Temple. These amounts are apparently invested by the chettiars but not on behalf of the depositors. Similar practices are followed by the temple-keepers on some of the estates in the Federation of Malaya. The history of the 10,000,000 acres of lower Burma rice lands which, prewar, through the inability of the peasants to repay the chettiars' loans, and the connivance of the Colonial authorities, passed over from owner-cultivators to moneylenders, is too well-known to be repeated in detail. See, e.g., E. H. Jacoby, *Agrarian Unrest in Southeast Asia*, New York, 1949.

pawnbroker operates almost entirely in the urban areas, while the moneylender has penetrated deeply into the rural kampong.[65] He may not have a local shop, but the village people do use him. The moneylender-boardinghouse keeper, as in the past, still fulfils an important role in the recruitment system of Pakistani and Chinese seamen in Malaya. A fourth type of moneylender is the person who borrows from the pawnshops on the security of a pledge. He pays 24 per cent. interest (p.a.) to the pawnbroker, but will re-lend the money so obtained at 72 per cent. (p.a.).

a. THE MONEYLENDERS

The chettiar's loan operates in the following manner. A promissory note is signed for the amount the individual wishes to borrow, say M$500, usually on the security of jewels, an automobile, gold, land or buildings. In some cases loans are granted without collateral. In the rural areas loans may be granted with the future crop as security. However, in all cases, the amount actually received by the borrower will be below that marked on the promissory note—in the example, say M$300. A rate of interest is charged on the amount mentioned in the promissory note, *not* on the amount actually borrowed. The interest may vary between 100 and 200 per cent (p.a.). If on the due date the borrower does not repay the principal, M$300, and the accrued interest, automatically the amount he owes will be M$500, on which the chettiar will charge a new, and higher, rate of interest. In the majority of cases, if the borrower repays certain amounts by the month, he is not given a receipt. Therefore, at law, he will still owe the total amount marked on the face of the promissory note. As he usually is a low earner, all he can do is to continue paying without raising any fuss. If eventually he is able to repay all at once what he owes, he will in fact have repayed the original loan many times over.[66]

The Chinese stallholder in Singapore and the Federation of Malaya borrows small sums from the chettiar to pay current debts. The usual rate of interest is M$1 in M$10 per month. In other words, if the borrower asks for a M$10 loan, he will only get M$9 but will owe M$10. Casual labourers, particularly now (June 1958) that unemployment in Malaya is rising,[67] borrow from *jagar*[68] to buy small amounts of food—rice, vegetables, meat and fish—with which to feed their families and themselves. The usual rate of repayment on one dollar is ten cents a day for thirty days. The interest is thus M$2 for having borrowed one, or approximately 2,400 per cent. interest (p.a.).

Far more serious is the situation of civil servants in the lower grades. Towards the end of 1956, the Singapore Cooperative Union Ltd., organised by and for the benefit of labour in private enterprise, and for Military Services civilian workers and Government employees, stated:

> "As a result of our investigation it is clear that the following abuses are widespread among certain classes of moneylenders:
>
> (i) The borrower is persuaded by the moneylender to sign a promissory note for more than the loan he actually receives;

65. The matter of moneylenders and their hold on labour, in Malaya, was raised by a representative of the Malayan Trade Unions Council, at the ECAFE Conference (Ceylon) in 1954. See also, *Singapore Standard*, March 18, 1954.

66. When money is borrowed on the security of an automobile, the lender may charge between five and eight per cent. per month interest. Before receiving the money, the borrower must complete a hire-purchase agreement which the lender then registers at the Registry of Vehicles.

67. Refer footnote (7).

68. Night-watchman, generally Punjabi.

(ii) The borrower agrees with the moneylender verbally to pay him a higher rate of interest than specified in the promissory note;

(iii) The moneylender fails to give due credit for interest and instalments of principal paid to him by the borrower;

(iv) The moneylender by frequenting the borrower's place of employment coerces the borrower into paying money (be it interest or principal) or signing a fresh promissory note which he would not otherwise have done, and the borrower by such methods is placed in a position of agreeing to any terms that the moneylender may desire to impose on him."[69]

An official investigation took place in Singapore, in 1957, by the combined sides of the Whitley machinery.[70] The Committee did not find it possible to assess the exact number of civil servants who were in debt, but other inquiries showed that indebtedness was widespread in all departments of Government. One department, with a staff of 600 officers, reported that between 1954 and 1957, 187 of them had been in debt and had their indebtedness rectified as follows:

91 became Judgement Debtors;

46 requested assistance from the Welfare Section;

22 had their affairs regularised by the Welfare Section;

28 were adjudged bankrupt.[71]

The majority of these officers had borrowed money from moneylenders.

A Government spokesman was quoted as saying that in one case a clerk on a M$180 per month salary was now indebted to the extent of M$16,000. He had used the amount to pay for his own wedding![72]

There are two types of moneylenders who operate in the vicinity of the Government departments in Malaya: the chetty,[73] and others exemplified by the Punjabi. The former are considered more reasonable them the latter. The officer will borrow, say M$120 at a certain rate of interest. He will repay the debt at M$20 per month. Every payment will be endorsed on the back of the promissory note. In case of default, the chetty will calculate the interest on the balance owing, and will go to Court for the settlement of the total.

The second type of moneylender operates in a much different manner. The officer, it is assumed, will ask for M$100. He will in fact sign a promissory note for three to five times that amount. The interest charged will be equal to one-tenth of the face value of the promissory note. The monthly repayments are not endorsed on the back of the note. Thus, the amount becomes a capital loan by the lender to the borrower. Assuming that the officer has borrowed M$500, which he must repay at M$50 per month, and he is three months in arrears (i. e. M$150), the moneylender forces the officer to sign a new note for

69. Singapore Cooperative Union Ltd., Circular S. 31/56: *Money-lenders Ordinance*, Singapore, October 30, 1956.

The moneylenders legislation in the Federation of Malaya makes it an offence for a moneylender to coerce in such a manner, but it is apparent that victimisation of this kind does continue.

70. See: Colony of Singapore, *Report on the Indebtedness of Members of the Civil Service by a Joint Committee Set up by the General Purposes Committee (Whitley Council)*, 3.7.1957.

See also C. Gamba, "Staff Relations in the Government Services of Malaya", *Malayan Economic Review, Singapore*, Vol. II, No. 2, October 1957.

71. *Report on indebtedness, ibid.*

72. *Singapore Standard*, August 18, 1957.

73. Colloquial for chettiar.

M$500 plus the M$150 defaulted. The lender may even give the borrower M$50 in cash and get him to sign a new promissory note. Punjabi moneylenders grant loans without security charging twenty per cent. per month or 240 per cent. (p.a.).

All the examples given up to date are based on actual amounts borrowed by certain personnel in the Civil Service. In one instance, an officer who initially borrowed M$200, became a debtor to the moneylender for M$6,000. In another instance, an officer earning a salary of M$130 per month, married and supporting his own family as well as a large number of relatives, borrowed three amounts: M$50, M$50 and M$100. He came to owe the moneylender M$3,000. By now he may have decided to go bankrupt. By so doing he will have been able to pay a much smaller monthly amount out of his salary, and to redeem his obligation once and for all.

The same type of moneylender will give a loan on the security of an officer's gratuity, or will even grant a loan merely because of the officer's security of employment. As the law stands at present, only death gratuities and pensions are safeguarded. Retirement gratuities are not. The chetty seem to have detailed information about each officer indebted to them, and as to how much gratuity each is entitled.

> "We also heard—the Report on Indebtedness says—of an instance when a moneylender produced the Government Staff List to prove how much an officer's salary was. . . .".[74]

Further down the scale—among the daily-rated labour in Government employment—one also finds indebtedness in various degrees. Here the main causes seem to be inadequate earnings in relation to the size of the family, and medical expenses, because only the wage-earner himself is covered by the Government medical schemes, and not his family. In many cases indebtedness is also chronic, in other words, it is indebtedness due to indebtedness.

Two root causes are suggested to explain indebtedness among the clerical group: gambling and a desire to live above one's income. Gambling is generally in the form of betting "off the course". Large amounts of money are also spent in buying lottery tickets, and are lost playing card games of chance such as *Soo Sik Pai* (四色牌)—the four colour cards—and on illegal betting at *Chee Fah* (字花)—or thirty-six numbers.

The desire to emulate the higher income group has expressed itself through the purchase of expensive cars and in other forms of social exhibitionism.[75] However, two other causes of indebtedness must be mentioned, namely, medical expenses and the necessity to support "expanded" families.[76] Probably the first cause is not

74. *Report on indebtedness, ibid.*

75. "Social exhibitionism" may also be explained as a desire to copy the way of life of the European (i.e. English) civil servant. In the colonial context "European" always implied highest "caste." The colonial institutions, education and psychological forces brought about a socio-pathological (inferiority complex) frame of mind, by which the nearer the Asian civil servant could go to the European's way of life, manners and dress, the greater the "face" he would acquire within his own group — not necessarily because that way may have been the best, merely because it was "European." Some relics of such attitudes survive today. Often enough the "rebel" or "subversive", in the colonial context, was he who did not conform to that way.

Refer also to e.g., W. F. Wertheim, *Het Rassenprobleem — De Ondergang Van Een Mythe* (in Dutch), particularly Ch. IV, The Hague (1948?); O. C. Cox, *Caste, Class and Race,* New York, 1948.

76. Comprising father, mother and the children, as well as relatives e.g., uncles, cousins and in-laws. See e.g., M. Freedman, *Chinese Family and Marriage in Singapore,* Singapore, 1957; Colony of Singapore, *Urban Incomes and Housing — A Report on the Social Survey of Singapore,* Singapore, 1956; Singapore, Department of Social Welfare, *Social Survey of Singapore,* 1947; F. L. K. Hsu, *Under the Ancestors' Shadow,* London, 1949; M. J. Levi Jr., *The Family Revolution in Modern China,* Oxford, 1949; M. C. Yang, *A Chinese Village,* London, 1947.

as valid as the second. The two Governments provide free medical attention to these officers and their families. It may be that certain improvements could be introduced and the system kept under constant review. The expanded family is a more genuine cause. The situation arises for both the Indians and the Chinese, and hardly ever for the Malays. This writer, during the collection of the material embodied in this paper, came across two extreme examples of this type of situation: that of an officer supporting eighteen members of his family, not including his own wife and two children, and that of a clerical officer employed in one of the Services, whose household included thirty children belonging to relatives staying under his roof and whom he, more or less, helped to support. It is undoubtedly true that even by leaving out such extreme cases, the customary loyalty expected from him who earns towards those members of his family—near and more distant relatives—who may be in financial distress, or unable to support themselves adequately, places a great strain on the resources of many civil servants, and leads them to the moneylender. Some of the Chinese civil servants in the divisions IV and III—and among the daily-rated—are probably weighed more heavily than any other by such an obligation, and are thereby more heavily indebted.

b. THE MONEYLENDER-BOARDINGHOUSE KEEPERS

The Chinese and Pakistani seamen in Singapore have always depended for accommodation while ashore on seamen's boardinghouses. There they could await employment and would be provided with food and bed as well as petty cash to meet their current needs. This situation has not greatly altered, particularly in the case of the Chinese seamen. The boardinghouse keeper has also been and still is the moneylender.[77] All debts are expected to be settled by the seaman immediately he secures employment. Verification of the amounts owed has always been very difficult. Even now an interest rate of about six per cent. per month is charged by the boardinghouse keeper on outstanding amounts.[78] Until a short while ago

> "Seamen living under constant threat of long and short periods of unemployment—a feature of their particular form of work—had to maintain good relations as well as continue to deal with the boardinghouse keeper. Unless this were the practice, the men would be refused accomodation and, therefore, the opportunity of being recruited."[79]

This was due to the fact that the recruitment took place through the boardinghouse keeper. He still operates in Singapore, and while he is no longer associated with the deck and engine-room *serang*[80] (with whom in the past he finally selected crews), he now follows similar practices with the connivance of seamen's trade union leaders. This applies particularly in the case of Chinese seamen who are thereby as indebted as their fellows were during the days of the *ghaut serang*.

c. THE PAWNBROKERS

The pawnshop is an institution which, in Malaya, traces its origins way back, so it is said, to the Chinese in Larut[81] who, after having been successful in the tin

77. Towards the end of 1957 unemployment among the deck-hands and engine-room artificers increased on the Singapore waterfront. The moneylenders moved in lending small amounts to these unemployed, on the promise of repayment when jobs would again be available.

78. See, S. R. Nathan, *The Nature and Extent of Work Done in Singapore for the Welfare of Merchant Seamen*, an unpublished research paper presented to the Department of Social Studies, University of Malaya, Singapore, 1954.

79. Nathan, *op. cit.*, p. 28.

80. Petty officer. Ref. Nathan, *op. cit.* Ghaut Serang or licensed Asian seaman supplier.

81. For the historical background to the opening of the Larut fields see e.g., F. Swettenham, *British Malaya*, London, 1907; V. Purcell, *The Chinese in Malaya, op. cit.*

mines, began to reinvest some of their accumulated savings by moneylending, and to the heads of the Kangchu[82] settlements who were given the sole rights of running the gambling farms, the pawnbroking business and selling *chandu* (opium). Some of the later pawnshops, on the other hand, operated originally in China and then, after the stream of migrants had successfully settled in Malaya, opened branches in the area. One pawnshop in Singapore[83] has almost two hundred years of unbroken history between China and Malaya. The pawnbrokers, both in the Federation of Malaya and Singapore, belong to the same clan. They are *Tai Poh Khek* (or *Hakka*).[84]

The usual, "legal", rate of interest has been between two and three per cent. per month (24 to 36 per cent. p.a.) according to the amount borrowed on the pledge. It is now (1958) twenty-four per cent. p.a. on all (Singapore) loans. The size of the pawnbroking "business" can be considered another indication of the poverty of the people of the region. In other words, *the more the business, the greater the poverty.*

The pawnbrokers, through time, have become also similar to investment bankers, accepting cash from friends and relatives and investing it in the business. The pawnshops, furthermore, are heavily backed by some of the Chinese commercial banks. It is through such loans, and from those of friends and relations, that many of the pawnbrokers have obtained their initial start, being willing to pay up to ten per cent. interest (p.a.) on borrowed capital.

The granting of pawnbrokers' licences in Singapore was, until a while ago, on a tender system, with the highest tender obtaining the licence. It is said that under the new Pawnbrokers Legislation,[85] the pawnshop business has been opened to the small man. Up to April, 1958, twenty-nine pawnshops were operating in the Singapore urban area, and three in the rural districts. The average annual fee for each was in the vicinity of M$31,000[86] and other authorities said that: "The fees range from M$6,000 to M$56,000 a year."[87] Informed persons explained to this writer that the business was "so keen" (!) that it could suffice for the opening of at least between sixty and one hundred more shops.

In the Federation of Malaya the pawnshops can be found in all States, mainly in the urban areas, but there are also pawnbrokers who, with a shop in the urban area, will cater for borrowers from the nearby rural districts. It is common for Malay villagers to borrow fifty cents, one dollar and one and a half dollars on their

82. Kangchu: Lit., 'owner of the river'. A system, giving permission to Chinese agricultural workers to form settlements along certain Malayan rivers for the purpose of planting pepper and gambier. It was abolished in 1917.

See also, State of Johore, *Government Gazette*, "Kangchu Rights Abolition Enactment," December 1, 1917; *Journal of the Royal Asiatic Society*, Malayan Branch, Vol. XIV, pt. III, December 1936: "The Kangchu System in Johore."

83. Lian Hin Jeweller and Pawnshop, South Bridge Road.

84. The word Hakka means "strangers" (K'o chia) and refers to the origins of the group. Khek was the name given to the group in the former Straits Settlements, from the Swatow and Amoy pronunciation of the word K'o.

The Hakka apparently originated from north China (Shantung Province). They were persecuted (approx. 249 B.C.) and began to travel southward, eventually settling in large numbers around Canton. See also, T. Dyer Ball, *Things Chinese*, pp. 279-282, London, 1926.

85. See, Legislative Assembly, Colony of Singapore: Sessional Paper No. Cmd. 62 of 1956, *Pawnbrokers and Pawnshops — White Paper on Government Policy*. Also, Colony of Singapore: Ordinance No. 12 of 1957, *An Ordinance to Amend the Pawnbrokers Ordinance, 10 May, 1957*. Also, similar legislation for the Federation of Malaya.

86. White Paper, *op. cit.*, p. 4, II (13).

87. Assistant Minister, Chief Secretary's Ministry, Singapore, Legislative Assembly: *Debates, Official Report*, Thursday, April 25, 1957.

*sarong*.[88] The Federation Government still grants licences on the highest tender system.

The turnover of business has been and still is "fantastic".[89] One Singapore shop inspected during February of 1958 had an average daily turnover of 247 loans and, another, 244 loans. The Police say that the minimum working capital is in the vicinity of M$300,000 but may go up to one million dollars. Tenders, in the past, have been very high. In one case, for instance, the amount offered per month was M$7,865. The revenue for the two Governments can be taken as another indication of the size of the pawnbrokers' business in Malaya and Singapore. In 1954, for the Federation of Malaya, it was M$2,366,000 and in 1956 it was estimated at $2,483,000. For the Colony of Singapore, the revised estimate for 1954 was M$1,048,000 and had risen to M$1,600,000 by 1957.[90]

The 'size' of the business can also be estimated by some straightforward arithmetical calculations. During the period July 1949 to July 1950, the volume of business amounted to almost M$9,000,000 monthly for all the pawnshops in Singapore. The press called it 'a boom for pawnshops'.[91] In other words, on this figure the total turnover of pawnshop business for the twelve months must have been in the vicinity of M$108,000,000. Ten thousand people passed through one shop alone and for one month borrowed M$500,000 on about 10,000 pledges.[92]

During May, 1951, after the Korean boom, it was estimated that of the thirty-two shops in Singapore, each did business at an average of M$40,000 worth of articles per month. This was much less than that between 1949 and 1950. Nevertheless, it meant approximately M$1,280,000 worth of business per month, or M$15,360,000 over the twelve months for all shops. Some of the bigger shops were operating up to M$60,000 and M$80,000 worth of pledges per month. In 1956, it was officially estimated that the amount of capital involved in the pawnbroking business in Singapore was perhaps not less than M$50,000,000.[93] In August, 1957, the Secretary of the Pawnbrokers Association of Singapore stated that, because of the increasing unemployment, the pawnshop business was passing through a period of expansion. According to him, the

88. Sheath, skirt, covering. The usual dress of Malays of all classes and both sexes, covering the lower part of the body.

89. This expression was used by one of the police officials who was kind enough to inform this writer on the administration of the pawnshops.

90. See Appendix D.

91. Quoted in the *Singapore Standard*, July 17, 1950.

92. Periodical auctions are held in Singapore and the Federation of Malaya at which pawnbrokers purchase the pledges they have put up for auction. Under the legislation, pledges can only be disposed of through such auctions.. See, Colony of Singapore, *Pawnbrokers Ordinance*, Chapter 216, 1936 Edition and amended legislation to 1958, and relevant legislation for the Federation of Malaya. For instance, once a week, every month, during 1951, the Singapore pawnbrokers publicly auctioned about M $150,000 to M $350,000 worth of unredeemed pledges, only for themselves to buy back about ninety per cent. of such pledges. During July, 1951, there were auctioned about M $300,000 worth of unredeemed pledges in one day (3.7.1951). In August, 1956, 20,000 lots of unredeemed pledges were sold in one day. See also, *Singapore Standard*, May 23, June 27, July 4, 1951; August 2, 1956.

In 1952, when tenders were called for the thirty-two pawnshops of Singapore, nearly 300 applicants sought to obtain licences. When the new Pawnbrokers Licensing Board (See, Colony of Singapore, Ordinance 12 of 1957, *op. cit.*) asked for applications, during April, 1958, it received more than fifty replies, although the legal interest rate on loans had been reduced to two per cent. per month for all loans.

See also footnote 58.

Repeatedly complaints have appeared in the press that pawnbrokers did not abide by the terms of the legislation — both in Singapore and the Federation — and that they charged different interest rates from those permitted by law. See, e.g., *Singapore Standard*, September 3, 1952; May 31, 1954; *The Straits Times*, Singapore, May 26 and July 1, 1954.

93. White Paper, *op. cit.*, p. 5, 18 (i).

capital employed during the previous six months (February-August 1957) had increased by M$10,000,000 to M$60,000,000.[94] In the Federation the "business" was apparently just as rewarding, particularly since the increase in unemployment due to the tin restriction scheme.[95]

Interesting though most unpleasant considerations arise out of such figures. Even though the averages do vary, and must in any case be on the low side, apparently the Government of Singapore, until a short while ago, was appropriating for itself not less than ten per cent. of the grand total of the business. That is, the Government was charging a ten per cent. tax on loans to the poorer inhabitants of the island. Secondly, how could the pawnshops offer to pay all the high fees, and yet, still make excellent profits, when the maximum "legal" interest they could charge was only three per cent. per month? Similar questions could be asked in the case of the pawnshops in the Federation.

The extent of the poverty of the people using the Malayan pawnshops is also shown by the practice of "selling" pawnshop tickets. In other words, after the borrower has pawned several pledges, and eventually has nothing more to pledge, but is still in need of cash, he will seek a buyer for his pledge tickets, selling them to him at a nominal sum. This traffic in tickets is a well-paying sideline for many small businessmen and, it is said, for the pawnbrokers also!

Are the pawnshops really doing "a public service"[96] to the community? This is a point open to serious argument. It would seem that all the various changes in the legislation, avowedly to control them more securely, and to lower the interest rate, have in fact worked totally to their benefit,[97] and not to that of borrowers. The Malayan pawnshops are still very much of a monopoly, an enterprise which, being allowed to prosper almost entirely out of the proceeds of poverty, want and destitution, provides high returns to its entrepreneurs, to those who invest in the business, while offering continuous encouragement to marginal corruption.

## CONCLUSION

The foregoing paragraphs have described only some of the institutional after-effects of poverty in Southeast Asia. This writer may be liable to criticism on a twofold count: for having said little, and yet too much. However, he has already explained that his aim was to draw attention to the variety of problems in this wide, almost virgin field of investigation, and thereby to encourage further and more intensive research.

94. Quoted in the *Singapore Standard*, August 29, 1957.

95. See also, *Report of the Ministry of Labour and Welfare*, Kuala Lumpur, June 1958.

On the situation in Malaya see also Aziz, in: *Some aspects* etc., *op. cit.*, p. 7, VI (1), who states: "The comment on Pawnshops on page 7 in the paper (1) prepared by the Secretariat applies *without reservation* (italics mine C.G.) to this country (Malaya)." The paper referred to says: "A majority of private pawnbrokers unscrupulously exploit the borrower. They are not interested in the redemption of the pawns. They would rather that the interest went on accumulating and that they retained the pawn after some sort of fictitious sale, thereby appropriating to themselves the surplus of the sale value of the pawn over the principal and interest. They discriminate between rich and poor borrowers. Their valuation of the pawns may be arbitrary and the pawns may not be properly taken care of during their custody. They may charge exorbitant rates of interest, for any limiting rates by private pawnbrokers or money-lenders is most difficult to enforce." ECAFE, Secretariat, *Small Loan Banks*, E/CN,11/I&T/WP.1/1.2, 26 September, 1951.

96. White Paper, *op. cit.*, p. 5, 18 (i).

97. The new (Singapore) legislation was praised by Assemblymen and Ministers in the Singapore Legislative Assembly. See, *Debates, Official Report*, Thursday, April 25, 1957.

In the developed areas of the West, poverty is usually associated with individuals — not masses. Unemployment in the West can, to a large extent, be explained through Keynesian theoretical analysis, though some people may disagree with this statement. But generally, Western poverty is socially caused and affects minor groups, or merely persons.

In Asia, poverty affects masses. It is linked to both social and political maladjustments. Keynesian or any other Western "pure" theory finds it heavy going, and becomes most unreal, when seeking to reason out the Asian situation of poverty and unemployment.[98] There is need, therefore, for a branch of economics that can effectively deal with Asian problems. It is probably because of its inevitable political aspect that foreign experts and economic advisers from international organisations have either shunned considering poverty, or refused to consider it as a problem *per se*. In their investigations they have thus given priority to food production, land usages, manures, secondary and technical education, medical care and investment capital. These are indeed important aspects related to underdevelopment. But the same experts have been reluctant to admit that unless political and institutional changes do take place in the region, their suggestions will be only partly effective, if effective at all.

Asian poverty is not only an economic, but also a political problem in the classical sense of the word. It must be attacked simultaneously on all flanks — social, institutional, technological, economic and political. It would appear then that the local economist, while seeking to refine his tools, and to achieve greater theoretical clarity, must definitely blend sociology and political theory with his economics. He must be, in other words, a socio-economist dealing with a variety of factors, many of them of the non-economic variety. Only he will be able to frame that body of theories needed in the underdeveloped areas, and to do so, he will have to organise schemes of intensive research for the assembly of the greatest possible array of facts on which to base such theories.

But, as Myrdal points out: " . . . To begin with, we need to free ourselves from the impediment of biased and inadequate predilections and unreal and irrelevant theoretical approaches"[99], and to make a valid distinction " . . . between *relevant* and *irrelevant* factors . . .".[100] Having in this way reached a proper frame of mind, the economist will be able to meet on its own grounds the challenge which, in Asia today, is directed at him not from within, but from without the ivory tower.

98. Basic economic principles are of course of general validity both in Eastern and Western regions.

99. Myrdal, *op. cit.* p. 164.

100. *Idem*, p. 10.

## APPENDIX A

### Postal Savings: Malaya

Federation of Malaya: Post Office Savings Bank (PSB):

| | | |
|---|---|---|
| Number of Accounts open at the end of 1955 | | 489,315 |
| Total Credit | M$ | 129,847,041 |
| Average Account | M$ | 265 |
| Total Population | | 6,058,317 |

Colony of Singapore: Post Office Saving Bank (SPSB):

| | | |
|---|---|---|
| Number of Accounts open at the end of 1954 | | 142,381 |
| Total credit | M$ | 55,042,497 |
| Average Account | M$ | 387 |
| Total Population | | 1,212,588 |

SOURCE: Report and Accounts of the Federation of Malaya, Post Office Savings Bank. 1955, Kuala Lumpur, 1956; Report of the Singapore Post Office Savings Bank for the year 1954.

NOTE: The average amount for 1956 (Federation of Malaya) was M $242 (unofficial).

Cf. Commonwealth of Australia,
Commonwealth Savings Bank, 1957:

| | | |
|---|---|---|
| Number of Accounts | | 7,726,000 |
| Total Credit | £A | 1,267,272,000 |
| | | (= M$8,617,439,600) |
| Average Accounts | £A | 166 |
| | | (= M$1,128) |
| Total Population (31.12.1956) | | 9,533,334 |

SOURCE: Australian Commission, Singapore: *Weekly Newsletter*, Vol. 16, No. 6, February 10, 1958, Department of the Interior, Commonwealth of Australia, *Fact and Figures*, No. 48, 31.12.1956.

NOTE: In the case of Malaya, the amounts include the Forces Saving Scheme whereby Military Personnel have deductions made from their pay and credited to a Saving Bank Account. Businessmen make good use of the PSB. See also, UNO, Formulation and Appraisal of Development Projects, Vol. I, p. 305 (a), 1951.

## APPENDIX B

### 1. Chinese Family Remittances

Malaya

M$

1948—1958

| Year | Singapore (*) | Federation of Malaya (**) | Total |
|---|---|---|---|
| 1948 | 10,228,010 | 5,500,000 | 15,728,010 |
| 1949 | 2,596,683 | 2,000,000 | 4,596,683 |
| 1950 | 13,168,879 | 6,843,989 | 20,012,868 |
| 1951 | 23,140,561 | 15,035,600 | 38,176,161 |
| 1952 | 15,634,207 | 13,382,000 | 29,016,207 |
| 1953 | 15,663,244 | 12,549,348 | 28,212,592 |
| 1954 | 15,502,338 | 7,900,000 | 23,402,338 |
| 1955 | 16,055,123 | 8,100,000 | 24,155,123 |
| 1956 | 17,201,226 | 8,906,359 (*) | 26,107,585 |
| 1957 | 15,245,741 | 7,011,536 (*) | 22,257,277 |
| 1958 (***) | 9,055,860 | 3,918,022 (*) | 12,973,882 |
| Total | 153,491,872 | 91,146,854 | 244,638,726 |

SOURCE: (*) Courtesy of Dy. Controller of Foreign Exchange, Singapore.

(**) Federation of Malaya, Annual Reports.

(***) January to June, 1958.

NOTE: Chinese family remittances are usually forwarded through Family Remittance Shops, licensed by the Government. These shops are permitted to collect from individual Chinese in the Federation of Malaya and in Singapore, a sum not exceeding M $45 per family per month. The amounts thus collected must be remitted within a week after collection through an authorised bank.

Chinese boardinghouse-keepers and Chinese shipping agents act as bankers, accepting deposits which are paid in Bangkok, China, Hongkong and Indonesia, to persons who have left Malaya, or their relatives and creditors, without actual cash having been transferred or proper banking transactions having taken place, between Malaya and these places.

A method of obtaining cash bypassing exchange regulations, is that used by Chinese leaving Singapore to visit China. They buy goods locally (in Malaya) reselling them personally or on behalf of someone else. Until a short while ago bicycles were such an item. Since the Chinese Government have forbidden this traffic, it has been replaced (1958) by oil-palm kernels bought by the ton in Singapore and sold in China.

## 2. Postal Remittances to India and Pakistan

M$

1948-1958

| Year | INDIA | | PAKISTAN | |
|---|---|---|---|---|
| | Fed. of Malaya | Singapore | Fed. of Malaya | Singapore |
| 1948 | 13,889,126 | 9,131,400 | 147,010 | 143,695 |
| 1949 | 13,165,892 | 8,241,722 | 562,953 | 456,350 |
| 1950 | 14,640,623 | 8,655,760 | 613,627 | 243,913 |
| 1951 | 23,046,388 | 13,374,012 | 1,124,105 | 426,523 |
| 1952 | 23,342,981 | 16,463,524 | 920,830 | 274,750 |
| 1953 | 21,510,199 | 17,762,333 | 424,162 | 112,214 |
| 1954 | 18,272,334 | 18,469,973 | 52,480 | 21,858 |
| 1955 | 19,904,499 | 18,840,065 | 159,570 | 68,578 |
| 1956 | 22,361,062 | 19,811,224 | 119,166 | 48,614 |
| 1957 | 21,949,133 | 19,101,864 | 84,228 | 26,335 |
| 1958(*) | 8,623,926 | 8,867,205 | 49,374 | 14,544 |
| Total | 200,706,163 | 158,719,082 | 4,257,507 | 1,837,374 |

(*) First half of the year.

SOURCE: Singapore, Ministry of Communications and Works; Federation of Malaya, Ministry of Works, Posts and Telecommunications; Central Account Office, Postal Services Department, Federation of Malaya.

NOTES

The figures in Table 2 include "business" and "family" postal remittances. They do not include "business" remittances through banks.

Furthermore, over and above these amounts there are other transfers, the size of which can only be guessed, namely:

a) Ceylonese residing in Malaya and intending to visit Ceylon, pay amounts to local moneylenders from whom they obtain coupons which they then exchange for money on their arrival in Ceylon, or forward to relations in that country. The exchange of coupons for Ceylonese currency operates, once again, through Chettiar moneylenders. This system allows for a more favourable rate of exchange;

b) Similarly, book transfers are made between Malaya and India through moneylenders who provide Indians, leaving Malaya, with "chits" exchangeable in India for cash;

c) Debts incurred in India, particularly land debts, are often settled in Singapore without a bank transfer having taken place between Singapore and India. The Indian "expanded" family group, with family members in India and Malaya, helps these transactions to be achieved with ease.

The desire by the Federation of Malaya and Singapore to obtain higher standards of living for their people, through higher efficiency in agriculture and urban industrialisation, would require for its achievement local as well as foreign capital. It would be advisable then to begin by making a careful and intensive study of all types of financial transfers taking place in the area, namely:

a) Size and character, destination in details, whether family or business, of transfers to India; and whether made by Malayan Indians or Indian nationals temporarily settled in Malaya and Singapore;

b) Similar study for Chinese transfers.

c) Size, type and destination of transfers by non-Asian firms and industries; character of such transfers, whether as savings, profits, dividends, "special reserves," interest on bank deposits, or profits made on transactions related to Malayan products, but entered into the books of such concerns at their headquarters "outside" of Malaya and Singapore, and size of profits obtained through the operation of interlocking directorates;

d) Size and character — and whether invested locally — of profits made by foreign banks in the Federation of Malaya and Singapore, through the use of funds deposited with them by the Governments and *quasi*-Governmental instrumentalities, particularly the profits out of investment of Governmental "short call" and "long call" deposits;

e) An assessment of the total drainage from the area, of such financial resources, and a consideration for its reduction.

The peculiar situation whereby local Postal Savings Bank deposits are invested abroad, thus helping in the development not of Malaya, but of foreign countries, has already been publicised by local economists, see e.g., footnote 10, Aziz, *Some Aspects etc., op. cit.*

# APPENDIX C

12 Members $10 monthly share-loan

M$

| Membership | Jan. | Feb. | Mar. | Apr. | May | June | July | Aug. | Sept. | Oct. | Nov. | Dec. | Loan No. | Total Contribution | INTEREST Bids accepted for every M$10 share |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| (Organiser) 1 | 10 | 10 | 10 | 10 | 10 | 10 | 10 | 10 | 10 | 10 | 10 | 10 | 1 | 120 | 1 |
| 2 | 9 | 9 | 8 | 9 | 6 | 7 | 5 | 8 | 10 | 10 | 10 | 10 | 8 | 101 | 2 |
| 3 | 9 | 9 | 8 | 9 | 10 | 10 | 10 | 10 | 10 | 10 | 10 | 10 | 4 | 115 | 1 |
| 4 | 9 | 9 | 8 | 9 | 6 | 7 | 10 | 10 | 10 | 10 | 10 | 10 | 6 | 108 | 3 |
| 5 | 9 | 9 | 10 | 10 | 10 | 10 | 10 | 10 | 10 | 10 | 10 | 10 | 2 | 118 | 1 |
| 6 | 9 | 9 | 8 | 9 | 6 | 10 | 10 | 10 | 10 | 10 | 10 | 10 | 5 | 111 | 4 |
| 7 | 9 | 9 | 8 | 9 | 6 | 7 | 5 | 10 | 10 | 10 | 10 | 10 | 7 | 103 | 5 |
| 8 | 9 | 9 | 8 | 10 | 10 | 10 | 10 | 10 | 10 | 10 | 10 | 10 | 3 | 116 | 2 |
| 9 | 9 | 9 | 8 | 9 | 6 | 7 | 5 | 8 | 8 | 10 | 10 | 10 | 9 | 99 | 2 |
| 10 | 9 | 9 | 8 | 9 | 6 | 7 | 5 | 8 | 8 | 7 | 7 | — | 12 | 83 | — |
| 11 | 9 | 9 | 8 | 9 | 6 | 7 | 5 | 8 | 8 | 7 | 7 | 10 | 11 | 93 | 3 |
| 12 | 9 | 9 | 8 | 9 | 6 | 7 | 5 | 8 | 8 | 7 | 10 | 10 | 10 | 96 | 5 |
| Total Collections | 109 | 109 | 100 | 111 | 88 | 99 | 90 | 110 | 112 | 111 | 114 | 110 | — | — | — |

## APPENDIX D

### Federation of Malaya
### Pawnshops Revenue
### M$

| Locality | Receipts 1954 | Estimates 1956 |
|---|---|---|
| Johore | 468,276 | 468,270 |
| Perak | 450,031 | 449,961 |
| Selangor | 395,438 | 389,220 |
| Negri Sembilan | 272,700 | 342,500 |
| Kedah | 231,962 | 290,000 |
| Penang | 228,108 | 228,100 |
| Malacca | 189,099 | 175,552 |
| Kelantan | 62,880 | 63,468 |
| Perlis | 30,996 | 30,996 |
| Trengganu | 24,672 | 24,672 |
| Pahang | 11,433 | 20,180 |
| Total | 2,365,595 | 2,482,919 |

### Colony of Singapore
### Pawnshops Revenue

| | 1954 | 1955 | 1957 | 1958 |
|---|---|---|---|---|
| Revised Estimate | 1,048,000 | 1,048,000 | 1,387,920 (1,600,000) (*) | 15,000 (**) |

*SOURCE:* Federation of Malaya, Estimates of the Federal Revenue and Expenditure for the year 1956, Kuala Lumpur, 1956.

Colony of Singapore, Estimates of the Revenue and Expenditure of the Colony of Singapore for the year 1958.

NOTE: (*) Actually received, unofficial estimate.

(**) The Singapore decrease for 1958 is due to the new system of licensing pawnbrokers in accordance with the Pawnbrokers (Amendment) Ordinance, 1957, Ordinance No. 12 of 1957.

# NOTES AND MEMORANDA

## A NOTE ON FUTURES TRADING AND THE SINGAPORE RUBBER MARKET

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*University of Malaya*

A recent decision of the Supreme Court in Singapore[1], which in effect renders forward contracts in the rubber market unenforceable, perhaps justifies some discussion on the economic function of trading in futures, since this may now be a subject of legislation. It can hardly be supposed that the Legislature, now that attention has been drawn to the facts by this decision, will allow an important part of Singapore's commerce to be regulated by laws which gave expression merely to English nineteenth century scruples about the correct method for the recovery of gambling debts among the Regency bucks of the time. Sound legislation about futures contracts must be based (among other things[2]) on a sound knowledge of their economic function.

A futures contract, in a properly regulated system, enables any individual who must plan now to buy or sell some product *at a future date*, to protect himself against the risks resulting from fluctuations in its price. Such a system can also reduce the total amount of such fluctuations, and make them more orderly, by allocating limited supplies of the product over time. Legislation should be judged by the extent to which it assists these functions.

We may distinguish, in principle, several different classes of operator in any futures market. There are those whose main interest is in buying or selling the product itself; those who are professionally interested in the relations between prices at different times, and changes in the statistical position (the professional futures dealers); those who gamble on the changes in price of a product, purely or mainly as a game of chance; and those who profit from some deliberate control over the processes of collecting and disseminating information. In addition there are brokers whose function is to act in the interest of their clients, for a fixed fee which is normally intended to replace any possibility of a commercial profit.

Those who buy or sell the product itself make up the fundamental market, since ultimately every futures transaction is designed to be either cancelled against another in the opposite direction or converted into a transaction in the physical product. But it is a matter of some importance that, when an active market in futures develops, speculative dealing may be on such a scale as to swamp (in any one month) transactions in the physical product. Those who trade in the physical product are not however in any sense the only legitimate interest.

Those who wish to hedge purchases for a given future time do not necessarily match those who wish to hedge sales. If, at existing prices, and with existing knowledge about the crop, the demand etc., the purchases to be covered, for a date three months ahead, exceed the sales, then more demands than offers will send the future price up. It will then be possible for those with storage facilities to buy stocks of the physical product and sell futures, making a certain profit out

1. S. E. Mizrahie v. Stanton Nelson and Co. Ltd. (1958), *Malayan Law Journal*, 24, p. 97.

2. This note is not intended to imply opposition to all legislation designed to control gambling on moral grounds, though these are not discussed.

of transforming one into the other. But even before this happens, if the margins are temporarily greater than the cost of carrying stocks, speculators will anticipate a narrowing of the gap, and will buy in the spot market and sell in the forward one knowing that it will be possible to close the transaction by selling spot and buying in the futures market when the range has narrowed.

Moreover, although time is a one way street, spot prices usually cannot exceed future prices, or cannot exceed them by more than a certain margin, depending on the commodity concerned. This is because, for most commodities, there are at any time considerable numbers of people carrying stocks which serve some practical function — e.g. securing bulk discounts or saving transport charges — and these stocks can be reduced if the price-spread between present and future makes them no longer worth carrying. The reductions possible in any given period will often be quite considerable in comparison with the normal flow of the physical product over this period.

A futures market functions efficiently if it enables the market to ration goods in accordance with anticipated scarcities over a limited range of future time. This can only be done by actual changes taking place in the volume of stocks carried; and at first sight it might appear that the person who anticipates a closing of the gap between two different prices performs no useful function when he first buys spot and sells forward and later sells spot and buys forward when the gap narrows.

Such a view neglects the important function of making a market, or bringing about a matching of different requirements. The person who has some general knowledge of the demand, supply and stock position can help to create the general situation in which the general run of traders, manufacturers etc. merely have to adapt their hedging and their stock position to existing prices and a more or less steady trend between spot and various future dates, at any given time. It is probable, in accordance with the general principle of specialisation and division of labour, that much more business is done and that stocks are better adapted to the existing state of knowledge in these conditions than would occur if every hedger, and everyone adjusting his stocks, had to match a violently fluctuating market, even if this gave greater profits. Studying the market is itself a specialised occupation.

It must be pointed out also that the mere gamblers, provided they are totally ignorant and operate more or less continuously, also help to make a market, simply by adding to the volume of business and making it more likely that any transaction can be conducted without either delay or a major price change.

Difficulties arise, as Keynes[3] has pointed out, when the proportion of gamblers becomes so large, and their reaction to irrelevant information so predictable, that the professional speculators find it much more profitable to attend to the reactions of amateurs than to the statistical position. The position is still worse if the amount of speculation is highly variable, being stimulated mainly by sharp price changes, and if the general state of information is poor.

In these conditions a futures market can actually add to instability rather than diminish it. Morever the channels of information become poisoned by the much greater profitability of giving misleading information; and the brokers themselves, who in principle should be protected from any temptation to distort information (since they should act purely as intermediaries paid on a commission basis), find that they can gain more by giving circulation to rumours which increase the aggregate amount of business than by attracting a larger share of business through reliability.

3. J. M. Keynes, *General Theory of Employment, Interest and Money*, London: Macmillan 1936, Ch. 12, vi.

It is probably hopeless to try to check the flow of unreliable news directly, or to prevent concentrations of power on a sufficient scale to influence the market. The aim should be to promote reliability by making distortion unprofitable.

Broadly it would appear to be undesirable to restrict future dealings, or even to allow them to be limited by removing legal protection from the credit involved. But the bias of the existing law in favour of those with a commercial interest in rubber could, if properly interpreted, be a useful component of new legislation. In order to indicate desirable features in new legislation it is necessary to consider some special features of the rubber market, as described in the case under discussion and in Mrs. Wilson's book[4] on the rubber market.

The market in Malaya appears to suffer from an inhibition about frank recognition of futures dealings which are not intended to lead to actual delivery. The hedging and speculative contracts are all disguised as circulation of tenders for delivery of rubber; with the consequence that hedging operations of regular traders and the most amateur gambling on margins are alike dressed up as something else.

Moreover rubber is a product with a most unstable price, and Singapore is probably a centre with an unusual widespread disposition to gamble. Although the world's principal rubber market is here there are no responsible weekly reviews, and information is based on hearsay and the commercial pages of newspapers, where propaganda stories manufactured by bulls and bears alike are naturally reported, usually without comment or appraisal.

In the circumstances it seems clear that legislation should concern itself not with whether contracts are wagers or not, but with trying to diminish the proportion of those who gamble erratically and on inadequate information. It is often assumed that, in order to prevent manipulation of the market, it is necessary to limit the operations of large concentrations of capital. But even the largest probable concentration can gain little from manipulating the market unless a swing of a few points can bring in large numbers of ill-informed speculators to make the manipulator's profit.

There is a further special point that arises from the fact that Malaya is relatively underdeveloped. The times when labour and skill are available in Malaya are the times when rubber and tin are relatively low in price. Some speculative buying of rubber, to prevent the price falling too far, probably is a good investment for Malaya, because it prevents heavier loss of income on the rubber sold abroad; but it is undesirable that at these times too much *local* capital should go into this channel. Speculative investment in *other* lines, at times when costs are low, would have secondary effects in stimulating economic growth. It is therefore particularly desirable that there should be speculative buying of rubber *from abroad* when the price is low.

At present virtually nothing is known about the forward position of overseas and Malayan interests respectively in rubber. An attempt is made to value the rubber entering into international trade, for statistical purposes, at the price actually paid; but in many cases this is quite unrealistic. The effect on Malaya's balance of payments statistics is quite considerable, and a remedy is greatly to be desired. Rubber is often shipped abroad without having been sold at all at the time the declaration is made. Hence differences between current prices and average declared values are almost useless as evidence of the effect of speculative dealings.[5] But in the absence of such information no one can say whether international speculation is at present helpful to Malaya or not.

4. Joan Wilson, *The Singapore Rubber Market*, Singapore: Donald Moore, 1958.

5. The problem of the valuation of rubber in relation to national income and balance of payments is too complex to be covered here. Current values, declared values and valuation for duty are all involved in a proper appraisal, and a knowledge of the forward position would help to introduce more consistency.

Any revision of legislation should of course be based on study by an expert commission. In summary, however, it is suggested that the following points need to be covered:

(1) Frank recognition that informed speculation on future prices performs a useful function even when forward purchases are intended to be matched by forward sales without giving or taking delivery of the physical product. This would make possible a modern clearing system with accounts kept in both money and rubber, and regular settlement of differences.

(2) Appreciation of the need to limit the relative amount of ill-informed gambling transactions and to prevent the amount from fluctuating too greatly, without preventing gambling altogether.

(3) Attempts to control more firmly any tendency of brokers, or the members of brokers' firms, to operate on their own account.

(4) Statistical records of business from outside Malaya, and measures to encourage informed overseas speculation.

It would appear that these requirements might best be met by changing the statutory form of the rubber market, limiting futures transactions to members but allowing membership — perhaps subject to a considerable fee or deposit — to speculators as such, and substituting a legally enforced professional code for some of the present "old school tie" functions of the Committee.

# INTERNATIONAL AID AND DOMESTIC PRICE LEVELS

*(With special reference to Vietnam)*

By Buu Hoan*

International aid may affect domestic price levels in two ways:— (1) Through its impact on the balance of payments; (2) Through the expenditures from the counterpart funds. The following simplified model shows how international aid may generate inflation or deflation throughout an economy, special reference being made to Vietnam.

We start with the assumption that there is monetary equilibrium in the economy, i.e., the following three differences cancel out:— the excess of exports (X) over imports (M), including in imports and exports the invisible items of trade; the excess of private investment (I) over private savings (S)[1]; and the excess of government spending (G) over government receipts (R). Thus:

$$(X\text{-}M) + (I\text{-}S) + (G\text{-}R) = 0. \qquad (1)$$

Inflation is then defined as an excess of demand over supply. Consequently monetary equilibrium is realised when equation (1) is equal to zero, and inflation (or deflation) takes place when equation (1) is positive (or negative).

There are three types of American aid: the Procurement Authorization (P.A.) system, the so-called Direct Aid, and the Project Aid. These affect the economy differently.

## THE PROCUREMENT AUTHORIZATION SYSTEM

Under this system, once aid is given it is actually drawn on in the form of imported goods and services. If other items in the balance of payments offset one another, the amount of such aid actually received over a period is measured by the import surplus (Mf) of the country during that period. The sales proceeds of the goods and services received are deposited in the so-called counterpart funds. The monetary effect of the latter depends on the extent to which they have been used during the accounting period concerned. The amount *actually* spent from the counterpart funds may be represented by the symbol (Gf). The new condition of monetary equilibrium for the whole economy is then:

$$(X-M-Mf) + (I-S) + (G+Gf-R) = 0. \qquad (2)$$

If condition (1) still holds, i.e., if there are no internal factors responsible for generating inflation or deflation, then:

$$-Mf + Gf = 0. \qquad (3)$$

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1. Savings are here defined as planned savings, or the amount people would be willing to save out of current income. Hence they do not include involuntary savings.

In other words the deflationary effects of an import surplus should be offset by an almost[2] equivalent amount spent from the counterpart funds in the home market.

As by definition,

$$Gf \leqslant Mf, \qquad (4)$$

international aid, taken as a whole, and isolated from other factors, can be neutral or deflationary, but never inflationary. The magnitude of its deflationary effects depends on the extent to which counterpart fund deposits remain idle during the accounting period concerned.

To what extent may the qualitative aspects of Mf and Gf affect price levels? Mf in general includes essential consumption goods, non-essential consumption goods and capital goods. A liberal import policy for essential consumption goods would have some deflationary effects on prices of home-produced agricultural goods, whether used for local consumption or for export. It would not inflate the income of the exporters and would be unlikely to reduce rural income to any large extent. Large imports of non-essential goods would be likely to have neutral effects on price levels, if an increase in luxury goods does not encourage consumers (particularly those of higher income groups) to save less, so that effective demand is not increased excessively. An import of raw materials and capital goods would, after a time-lag, cause a fall in price, due to an increase in domestic output.

In the absence of any policy by the government, and with conditions similar to those existing in Vietnam in 1955 (i.e., with a large supply of foreign reserves and when prices were rising), the demand for imports can be determined by (1) the relative prices, and (2) the excessive effective demand created by windfall profits. The increasing incomes arising from government expenditures are spent on domestic products as well as on imports. Since the supply of domestic goods is much less elastic than the supply of imports, prices of domestic goods, relative to those of imports, rise more than would have otherwise prevailed.

Under these conditions it is likely that there is a strong initial demand for essential consumption goods, but the rise in the price of imported goods results in windfall profits to the importer, and this tends to increase the demand for non-essential consumption goods. The demand for raw materials and imported capital goods depends on the confidence in the nation's political stability, on investment opportunities, and on the availability of techniques and equipment. In general, the incentive to invest in fields other than consumption capital such as housing, hotels, and theaters, is small in Vietnam. Further, the availability of foreign exchange may increase imports more than encourage domestic production; this is especially so when domestic industries cannot compete with imported goods.

The inflationary impact of the disbursement of the counterpart funds (Gf) depends also on the nature of this expenditure. If they are used to support the government budget, particularly for a military program, the increase in effective demand is immediate. If they are used to finance investment programs, the inflationary pressure will, after a time-lag, be offset by the increase in production. Counterpart funds may also be used as a mechanism for the mobilization of domestic capital. For instance, the counterpart funds generated by United States commodity assistance to India were used as rupee capital for the government-supported Industrial Credit and Investment Corporation. In these cases of

2. "Almost" is added because of this qualification; Gf will generate new incomes, and when these are spent, they give rise to further increases in income to an extent which is determined by the multiplier. The total increase in income is thus in due course larger than the primary increase in the previous period.

promotion of investment, their impact on the finance of the country will depend on whether inflationary or non-inflationary conditions are prevalent, or whether idle resources exist. When counterpart funds are used to offset inflationary pressures, they are deposited in a blocked account and are subsequently retired in one way or another.

### THE DIRECT AID SYSTEM

So far we have assumed that the foreign exchange grant is used to finance import surplus, the sales proceeds of which constitute the counterpart funds. The dollar grant may be used to purchase local currency to cover government expenditures (Gf'). Its foreign exchange holdings would then provide additional available means in real resources, and help to finance additional imports (Mf'). The new condition for monetary equilibrium for the whole economy will be:

$$(X - M - Mf - Mf') + (I - S) + (G + Gf + Gf' - R) = 0. \qquad (5)$$

If conditions (1) and (3) still hold, the new monetary equilibrium for this specific type of aid is

$$-Mf' + Gf' = 0. \qquad (6)$$

or, *ceteris paribus*, the inflationary effect of government expenditure covered by ICA[3] purchases of local currency should be offset by corresponding additional imports.

But now, as

$$Gf' \geqslant Mf', \qquad (7)$$

this procedure, taken in isolation, can be inflationary or at best neutral, but never deflationary. If the government uses the foreign exchange to import goods and services from abroad, effective demand in the home market will not increase as much. But if the government allows the foreign reserves to pile up, effective demand and income will expand. The rise in home market demand, however, may be diverted to demand for additional private imports, though these imports may not use up all the additional foreign exchange reserves. The government may increase government receipts by selling foreign exchange to the private sector for hoarding. In this way, it reduces private expenditures for goods and services, thus effecting a transfer of domestic real resources to the government at the cost of reducing the government's command of foreign resources.

### PROJECT AID

There is another type of aid — Project Aid — or aid in kind to the government without the setting up of a counterpart fund. To the extent that it provides imported goods to the government which should be covered by government receipts, R, it then decreases G. If goods could be sold or given to the private sector, it would increase R or M. In any case, the result is deflationary (or anti-inflationary).

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So far we have assumed that the recipient countries have enjoyed price stability when International Aid comes into the picture. In actuality, e.g., before the Marshall Plan came into being, all the recipient countries had suffered for a long time from inflation originated by war devastation, or by their own development programs. International aid came to their rescue, partly to help solve the so-called dollar shortage, and partly to release inflationary pressures. Counterpart funds were set up primarily for the second purpose (besides the other objective of

3. International Cooperation Administration.

exerting some American influence on the development program). The anti-inflationary concept of counterpart funds was then enshrined in the Economic Cooperation Act of 1948, by which ECA was allowed to withhold the approval of the use of the counterpart funds if the country proposed to use them in an inflationary way. In fact, this did not prove as effective as had been hoped. Recipient governments still had many other techniques at their disposal to change the supply of money and the flow of expenditures. Sophisticated England, for instance, would allow the counterpart funds to pile up for months at a time. British monetary authorities offset the sterilizing effects of the immobilization of bank reserves by open market operations to maintain appropriate levels of reserves.

Another point of our analysis should be borne in mind. Our conditions of monetary equilibrium (equations 1, 2 and 3), when taken separately, are neither necessary nor sufficient. What matters in the control of inflation is the overall equilibrium as expressed in (5). There will be no inflation if imports are appropriately larger than exports, so that the excess of imports offsets all government expenditures and the inadequacy of private savings. One method of controlling inflation often resorted to by many modern governments is to reshape fiscal policy in such a way as to create a budget surplus large enough to offset the excess of I and the excess of X.

# BOOK REVIEWS

Shu-Chin Yang: *A Multiple Exchange Rate System: An appraisal of Thailand's experience 1946 - 1955*

(The University of Wisconsin Press — Madison 1957 — XVIII + 200 pp. – 4 charts & 33 Tables – U.S.$3.00)

As Professor Ellsworth says in the Introduction, analytical works on multiple exchange systems are rare. Books on Thailand's economy are rarer still. Dr. Yang's study of Thailand's postwar Exchange system is therefore especially welcome, particularly because it is lucid, readable, objective and full of interest.

After describing the general characteristics of the economy and the wartime financial problems (Chapters 1 & 2), the author devotes four chapters to the development and analysis of the exchange system 1946-51, and discusses it in relation to the balance of payments, the foreign exchange policy of the Bank of Thailand and the internal situation. Chapter 7 affords a pause with a "diagrammatic recapitulation". The whole of the next chapter deals with the puzzling policy of currency appreciation in the difficult year of 1952. The simplification of the rate structure in 1952-54 is the subject of Chapter 9. The text ends with an interesting discussion on the merits and demerits of the system compared with alternative measures. The wealth of statistical data which fill the last 50 pages will be very valuable to students whose access to official figures is normally limited.

Set up in the postwar years of shortages, the multiple exchange system of Thailand was designed, not to promote the export of the few surplus commodities —rice, rubber and tin — but in general to build up the official exchange reserves, to make imports cheaper for the Government, and to mop up surplus local currency. Hence, tin and rubber exporters were compelled to surrender their foreign exchange earnings to the Central Bank at rates unfavourable to them. In the case of rice, the concern was to keep domestic prices at levels much lower than world prices, and ensure adequate supplies for domestic consumption. A Government Rice Office was established as a monopolistic organ in international trade, and the foreign exchange proceeds of rice exports had to be surrendered at a low official rate. A small fraction of the foreign currencies thus acquired by the Authorities found its way back to the free market, and this, in addition to the earnings of uncontrolled exports was bought by importers in general at higher exchange rates. Government expenditure and a few categories of imports enjoyed the privilege of the official rates.

This system operated for several years from 1946. After the turn of the world commodity market in 1952/3, there was a period of irrational governmental interference in the exchange market, which proved costly to the official reserves. The unification of the rates and abolition of the Government Rice Bureau took place in 1954-55. An Exchange Equalization Fund was established and taxation and export premia replaced the differential rate system. This new regime still operates today.

Dr. Yang's clear exposition in the first six chapters is very laudable. Although Thailand's principal exports are few, the numerous regulations and their frequent amendments formed a complicated jungle through which the reader is guided without too much demand on his efforts. I believe that the period 1953-55 has been dealt with rather summarily. Moreover, regrettably the book stops short with the birth of the Exchange Equalization Fund in March 1955, which is not

the end of the episode. With another chapter bringing the book to the end of 1955, the study would have gained much in completeness.

On the whole, the author approves of a multiple rate system in a country like Thailand in a period like 1946-1955. Its superiority over alternatives (quantitative exchange restriction, trade control, devaluation, etc) is clearly demonstrated in the last chapter. The more impersonal rule implied in the multiple rate system, moreover, imposes less strain on the integrity of officials and traders alike. The system is, however, by no means foolproof. Dr. Yang is too polite to call the foolish policy of "administrative appreciation of the free baht" in 1952 by its real name. Perhaps the same motive prevents him from mentioning that the Governor of the Central Bank resigned on account of that policy. I cannot help feeling that in a country like Thailand, a discussion of policies must inevitably lead to discussing personalities. Another instance is the change in the rice export policy in 1954, which cannot be fully understood without referring to the cabinet reshuffle, particularly at the Ministry of Economic Affairs.

I offer a few minor criticisms:

a) On page 75 the exchange profit of the Bank of Thailand on the "Stabilization Account" is stated to be the property of the Bank. In fact it is not so. The Bank held this profit as a trust fund on behalf of the Nation. Part of this account has subsequently been used for writing off Government debts to the Bank of Thailand.

b) The status and number of the Chinese in Thailand are, by the nature of the subject, not clearly defined. Dr. Yang rightly says on page 6 that out of about 2.5 million Chinese, fewer than 500,000 are foreign born. When the size of foreign investments is discussed (p.8), however, I believe Dr. Yang includes among them the capital assets of second — and third — generation Chinese. These, in my opinion, should be treated as domestic capital.

c) I doubt the appropriateness of certain terms used by the author. For instance, the phrase "quantitative exchange restrictions" used for the new system of 1954 (p.123) has quite a different meaning from that used by the International Monetary Fund. I wonder whether Thailand could rightly be called "an *atomistic* seller of rubber and tin in the world market" (p.16). Thailand's position as a rice exporter in the immediate postwar period is described as "oligopolist" on p.16, but on page 48 it is stated that "the demand curve facing Thailand appeared to be *somewhat less than perfectly elastic*".

Finally, the account of the "Formal (peace) Agreement" between the British Commonwealth and Thailand in 1946 (chapter 3) should provoke students of welfare economics to thought. For a period starting in 1946, Thailand was compelled to deliver to the British Commonwealth large quantities of rice at about one half of the price paid for Burmese rice; this was equivalent to less than one tenth of the price prevailing in Malaya. The British Commonwealth would have achieved the same result by forcing Thailand to deliver the same quantities of rice at commercial prices, and extracting the same amount of war reparation from Thailand in cash. Would that not have been wiser and less disturbing? For one thing, smuggling would not have been so widespread; and for another, the foreign exchange problems would not have been so much aggravated. These problems in fact had far-reaching repercussions and some of them still persist to the present day.

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Peter G. Fousek, *Foreign Central Banking: The Instrument of Monetary Policy* New York: Federal Reserve Bank of New York, 1957.

This monograph gives a very useful survey of the revival of monetary policy in the postwar years, with special reference to the adoption of new techniques by central banks outside the United States.

The introduction explains the factors leading to the revival of central banking control in the past decade and gives a general view of the postwar trends in central banking techniques in countries other than the United States. In the following five chapters the various instruments of central banking policy are discussed in turn in the light of postwar experience in underdeveloped countries as well as in advanced countries. The final chapter contains an account of the money markets, on which effective implementation of monetary policy depends, and outlines the measures taken in a number of underdeveloped countries since the end of World War II to strengthen and establish money markets.

The three principal instruments of monetary policy which are discussed first are:—

(a) Discount rate policy;

(b) Open market operations; and

(c) Cash reserve requirements of commercial banks.

These three weapons of quantitative credit control are in various countries supplemented by minimum liquidity ratios on the one hand and techniques of selective qualitative credit control on the other. The most useful portions of the discussion on weapons of monetary control are the references to the experience of underdeveloped countries in the application and adaptation of these techniques. The discount rate has since 1954 been restored to something like its prewar importance. Although present day economic setting imposes various limitations on the effectiveness of the discount rate weapon and its roles in underdeveloped countries is still rather subordinate, the discount instrument remains an essential credit control tool.

The postwar experience with open market operations is discussed with specific reference to institutional conditions in the United Kingdom, Canada, Continental Europe and other countries including the underdeveloped countries of Asia and Latin America. In spite of important advances made in the use of this weapon, the existence of many institutional obstacles has prevented open market operations from becoming the major tool of credit control. One of the main obstacles in the less developed countries, for example, is the absence of sufficiently broad money and capital markets. The broadening of such financial markets is, of course, largely dependent on continued economic growth and diversification. Nevertheless, the central banks in many of these countries have already contributed significantly to the development of such markets both by helping to create a proper institutional framework and by nourishing the further growth of these markets.

Owing to the limitations of open market operations, many of the less developed countries have turned their attention to another important credit control instrument, viz., variations in the commercial bank minimum cash ratios. Since the war many Asian and Latin American countries, for example, have given their central banks statutory authority to establish and vary the cash reserve requirements of commercial banks. In fact in the less developed countries with thin financial markets, the instrument of variable cash reserve ratios has become the principal means of influencing the amount of cash reserves available to commercial banks, thereby strengthening the effect of discount rate and open market policy.

A new weapon of quantitative credit control developed since the war is that of minimum liquidity ratios, sometimes called combined cash and securities requirements. These minimum reserves,which commercial banks are required by law to maintain, are in the form of prescribed liquid assets, such as cash and government securities in specified proportions of their deposits. In effect such reserves ensure that commercial banks' holdings of Treasury bills and other government securities remain at not less than a prescribed minimum. In some advanced countries, these ratios have been used to halt excessive expansion of bank credit, while in a number of the less developed countries in Asia and Latin America, they have been used as instruments of selective credit control.

In conditions of extreme bank liquidity, minimum liquid ratios have proved effective in restraining credit expansion, although their usefulness in less strained circumstances is more difficult to appraise. What is certain is that the technique needs to be reinforced by appropriate budgetary and debt management policies.

In the less developed countries, liquidity ratios have been used mainly as an instrument of qualitative credit control. They have, however, not been very successful as a means of directing "non-governmental expenditure into desired channels, through the inclusion of bank loans among the reserve-eligible assets." In Asian and the Latin American countries, they have enjoyed only moderate success in helping to develop a market for government securities, although "they have resulted in lodging a portion of the government debt in the commercial banks' portfolios."

In the postwar years, a wide range of other devices have been used as tools of qualitative and selective credit control and these are reviewed in detail in the chapter on "Selective and Direct Credit Controls". The development of selective credit controls illustrates the trend towards devising new tools in order "to adapt monetary policy to particular situations or economic and institutional settings." Selective controls have been more effective as supplements to quantitative credit restraints than as substitutes for general credit controls. They perform a useful function in underdeveloped countries, where general quantitative credit control instruments are inadequate and where the absence of broad and active markets in short-term securities seriously hampers the flexible and effective use of open market operations.

The development of the money markets in recent years is presented in a compact survey in the final chapter. The survey includes the London money market and the money markets in Continental Europe, the British Commonwealth, Asia and Latin America. The most useful section, from the point of view of Malayan economists, is the one dealing with the broadening and establishment of money markets in Asian and Latin American countries. The experience of these countries is aptly summarised in the following concluding paragraph:-

"The development of broad and flexible money markets, as recent experience shows, is a slow and often difficult process. A country's economy must first expand and diversify, and a money market must not merely be able to draw upon a well-organized banking system; it must also be able to draw on a supply of short-term funds from nonbank sources interested in a relatively low return in exchange for high liquidity. Nevertheless, central banks and governments have had considerable success in developing money markets since World War II. The development of these markets has in turn helped the various countries to adapt their financial resources to their own needs for liquidity and investment, and has provided facilities through which the selection among alternative uses of funds could be resolved in greater degree by reliance upon competitive market forces."

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